MEXICO

IL&T

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CURRENCY *The peso, with a controlled exchange rate of P1,305:$1 and a free rate of P1,306:$1 on June 15, 1987.*

SEE ALSO *Latin America Introduction for LAIA-wide Rules, Basic Market Statistics and Comparative Taxation.*

In the Past Twelve Months

•In October 1986, Mexico's creditors put together a debt rescue package that included a rescheduling of half of the country's $100 billion foreign debt. The deal also includes some $12–13 billion in new money from official, private and government lenders. Disbursement of some $6 billion in new commercial bank money began in April 1987, after a protracted delay (1.03).

•The sharp drop in oil prices over the first half of 1986 sent the economy into a deep recession, with real GDP growth dropping by 3.8% (1.03).

•Mexico introduced a sweeping and enormously complicated new income tax system designed to counter the distorting effects of inflation on corporate tax bases. The plan will be phased in over five years, beginning in 1987 (8.02).

•Mexico enacted changes in its patents and trademark regulations. A major disappointment was its decision to put off considering product patents for chemicals and pharmaceuticals for a period of 10 years (6.02).

•The country entered GATT in August 1986 under favorable terms and immediately began to phase in key features of its accession pact (13.01).

In the Next Twelve Months

•President Miguel de la Madrid will select the PRI candidate for president in October. The candidate will be assured victory in the 1988 elections (1.01).

•The economy will grow at an extremely sluggish clip of around 1–2%, with inflation approaching 150% (1.03).

•Mexico will likely make further modifications to its income tax law in December 1987 (8.02).

•In August 1987, Mexico and the US are expected to sign a bilateral accord providing a framework for improving trade and investment relations (13.01).

•By the close of 1987, Mexico will have eliminated all remaining reference prices (13.01).

1.00 INTRODUCTION

1.01 Political forecast. Mexico has enjoyed more than half a century of political stability, a record almost unequaled in Latin America and often cited as the chief reason for the country's success in developing its economy and attracting foreign investment. At the heart of this stability is a unique one-party system centered around the Partido Revolucionario Institutional (PRI), founded in 1929.

The PRI dominates Mexican political life. Its wide power base encompasses labor, the peasantry and the lower classes, and it has strong links with industrial and financial interests. The party hammers out policy consensus by using a time-honored system of private consultation and reciprocity among political groups. It has no single party line and often experiences strong pulls between its liberal and conservative factions. Opposition is normally squelched through outright repression or, more commonly, cooptation.

Mexico's political future, however, hinges to a large extent on the PRI's ability to adapt to the nation's changing economic, political and social realities. In many crucial respects, the party has resisted those changes. If it continues to do so, its integrity will be eroded and the stability of Mexico's political system will be seriously threatened.

Discontent is most evident among the middle class, whose fortunes fell drastically when the boom years ended. Many have joined the opposing National Action Party (PAN), which has developed a significant following in the northern states. Discontent among the middle class has also given rise to independent grass roots organizations in the ecology movement, and in the reconstruction efforts following the September 1985 earthquakes. Independent leftist unions have also been gaining influence on the periphery of the official labor sector and represent the only left-wing force with any power base.

But the PRI's political hegemony will not be seriously challenged in the near term. It is a foregone conclusion that the PRI will win the 1988 presidential election and retain control of the legislature and all governorships.

Early 1987 finds Mexico engrossed in preparations—political and economic—for the announcement of the PRI presidential candidate in October. The government's objective is to gradually restore growth while controlling inflation and keeping balance-of-payments problems at bay.

The chief preoccupation at the moment is obtaining economic growth and reducing political discontent and tensions so as to allow for a smooth election of the next president. The resolution of a potentially troublesome student strike at the National Autonomous University and the move of Pemex Director Ramon Beteta out of the oil company to campaign for governor of the state of Mexico has relieved two crucial areas of political tensions. In recent months, the cabinet has taken a tough line in dealing with labor over parastate wage increases. Its declaring illegal an electrical workers strike and tough maneuvering with the telephone workers have strained labor relations somewhat. Labor will have to receive something in coming months to assure full cooperation in the electoral process. This could come in the form of higher wage increases in July and October or other legislative tradeoffs. De la Madrid hopes to announce his choice of the PRI presidential candidate in an atmosphere of relative calm.

Three cabinet members are considered the top contenders for the presidential post: Planning and Budget Secretary Carlos Salinas Gortari; Energy, Mines and Parastate Secretary Alfredo Del Mazo and Interior Secretary Manuel Bartlett. All three are likely to provide some continuity to the de la Madrid administration's shift to export-oriented growth and reduction in the size of the parastate sector. Of the three, Salinas Gortari, who has been the major economic thinker, would be most likely to continue the current policy focus. Del Mazo would perhaps be the most tempted to try to rule through populism, and Bartlett would perhaps be more conservative than de la Madrid. None of the potential candidates is expected to break new ground on the political front unless a crisis develops. One major challenge will be dealing with a post-Fidel Velazquez labor movement, which might not be as susceptible to government control as in the past.

On the economic front, the administration is facing an increasingly difficult choice between allowing continued three-digit inflation and obtaining some positive growth in the economy this year. Its commitment to labor to do more to stem the drop in real wages has also pushed it into a quasi-indexation of salaries, albeit indexation below the actual CPI. Delay in the arrival of foreign financing (until late April 1987) has further pushed back Mexico's growth prospects for 1987.

1.02 Attitude toward free enterprise. Mexico's official economic policy centers on a mixed economy, a blend of state control and conventional capitalism, to bring about social improvements. The nationalization of the banking system in 1982 put extra weight on the already heavy public sector. While maintaining a major government role in the economy, de la Madrid has moved, albeit slowly, to sell off unproductive firms. Those firms that are being kept are operating under tighter financial controls. While a shortage of funds has prevented it to date, the government plans to improve the technology of the core firms that will be maintained. Scarcity of resources will likely lead to a continuing reduction of the parastate sector. The government, however, will continue to be the dominant economic decisionmaker in the years ahead.

The administration will continue to exercise control over private companies through increased regulation, particularly of priority industrial sectors. Free enterprise and foreign investment are permitted as long as they do not interfere with government development goals or dominate ownership of productive resources. Competition from state-owned enterprises can be intense and often takes place on unfair terms (2.00).

1.03 Market forecast. In 1986, Mexico weathered the combined ills of the steep drop in oil prices and the lack of any compensating foreign funding, except for a $1.1 billion bridge loan, surprisingly well. Tight credit policies, rapid devaluation and high interest rates prevented a full-blown economic breakdown. Lack of financing and high real interest rates also caused a return of nearly $2 billion in offshore funds during the year, helping to maintain necessary reserve levels. Nevertheless, the cost has been high in the area of inflation, which ended the year in three digits, a burgeoning unemployment rate and sharp economic recession. The economy declined by 3.8% in terms of GDP; the nominal budget deficit hit 16.2% of GDP; and inflation rose to 105.7%.

The de la Madrid administration will complete its term with the lowest average GDP growth rates in modern Mexican history. This comes at a time of massive growth in the labor market. As a result, the pressure for stimulative policies will be intense over the next two years. Growth will continue to be a priority concern of the next administration. Mexico contends that it must be allowed to grow in order to service its debt.

Mexico's success in winning renegotiation of $44 billion in previously restructured credits (including a drop in interest rates from LIBOR plus 1.13 to 0.813) and some $12 billion dollars in new money over the next 15 months will provide balance-of-payments stability through the 1988 presidential succession. Mexico's current account will also be aided by a moderate improvement in international petroleum prices. The only major external downside risk in 1987 will be the potential for a rise in the US prime rate later in the year.

However, delay in receiving the credits—some $3 billion was originally to have been disbursed in 1986—has pushed back growth prospects for the economy in 1987. Also, without an improvement in financing availability, growth will continue to be slow. Inflation will likely remain in the three-digit range through the end of 1988. The crucial period for balance-of-payments sensitivity will be between April 1988, when the agreement with foreign creditors expires, and December 1988, when the new president takes office. Capital flight will increase during this period as part of the historic election-year cycle.

Liquidity has been tight since July 1985 when Banco de Mexico, the central bank, significantly tightened restrictions on the amount of new bank funds available for lending to the private sector. The move was originally billed as a three-month temporary measure, but has been continued into 1987. This means that when mandatory reserves and specially earmarked funds are calculated in, some 93% of all bank resources are controlled by the government. In 1986, financing to the private sector totalled P8.1 trillion—a drop from 11.2% of GDP in 1985 to 9.9% of GDP in 1987.

During 1986, gross fixed investment fell 12.7%, vs growth of 5.5% in 1985. Private investment fell 12.8%, and government investment fell 19%. Investment in machinery and equipment fell 12.6%, after increasing 13.8% in 1985. Construction investment fell 12.6%, following 2.6% growth in 1985.

Mexico's in-bond assembly, or *maquiladora*, industry showed strong growth in 1986, with the number of plants reaching 925. The in-bond industry is now the nation's second-largest source of foreign exchange earnings, but rapid devaluation of the peso cut the growth in valued-added to just 1%, or $1.28 billion, in 1986, vs 10 and 41% respectively in 1985 and 1984. Growth should remain strong in 1987, with the number of plants rising to 1,100 and value-added increasing 15%, to $1.5 billion.

Mexico will enjoy a temporary balance-of-payments cushion in 1987 given new foreign creditor financing. Pressure will mount again in the second half of 1988 as capital flight picks up and the latest financing package expires.The current account deficit, after falling to $1.27 billion in 1986, will improve to $1 billion in 1987 but then worsen in 1988.

Pressure for increased government spending in preparation for the presidential elections will continue to push up inflation. The CPI will jump from 105.7% in 1985 to around 140% in 1987, unless the government opts to wait until 1988 for economic reactivation. Push-back of the presidential elections from June to September gives the administration a bit more room to maneuver, but pressure for some growth this year will be intense. The cumulative CPI rise for first-quarter 1987 was 21.9%, virtually eliminating the government's hope of reaching its original year-end target of 80–90%. Ultimately, officials may have to go the route chosen by Argentina and more recently Brazil in freezing wages and prices. Such a move will probably not come until the new president takes office in December 1988.

1.04 Currency outlook. Since December 1982, a two-tiered exchange rate has been in force. The controlled rate, which stood at P1,305:$1 in June 1987, is essentially used for all imports and foreign debt payments and to convert export proceeds. The free market rate, P1,306:$1 on June 15, 1987, applies to all other transactions. The minuscule difference between the two rates in recent months has lead to widespread use of the free rate for most transactions as there is less paperwork involved. During 1986, Mexico employed a rapid devaluation of the controlled peso—148%—to attenuate the balance-of-payments pressures and provide effective protection to domestic producers as the GATT trade opening was implemented. The free rate fell a less dramatic 104.4%, leading to brief equality in the rates in December. Officials have become adept at maintaining a realistic exchange rate through small daily slippages. Also, high interest rates in 1986 led to a return of flight capital to Mexico, which helped steady the free rate.

Devaluation during the first quarter of 1987 has basically been in line with inflation after lagging inflation the first two months and catching up in March. The free peso fell 22%, while the controlled rate fell 20%, vs first-quarter inflation of 21.9%. Peso volatility will likely pick up in the third and fourth quarters, however, as political jitters increase with the naming of the presidential candidate. The spread between the free and controlled rates could easily widen again as the free rate is allowed to run up to discourage dollar buying.

As inflation picks up devaluation will be increased. The peso should fall sharply to a P2,400:$1 free rate and a P2,200:$1 controlled against a 140% rise in the CPI. The differential between the rates could rise to 10% by year-end.

1.05 Attitude toward foreign investment. Economic nationalism has become a permanent fixture in Mexican politics, and many controls on foreign equity, technology transfers and patents and trademarks have been introduced in recent years (3.00, 6.00). Foreign investment in Mexico is regulated by the 1973 Law to Promote Mexican Investment and Regulate Foreign Investment (3.00, 6.00).

Officials acknowledge the need for foreign investment in selected areas—mainly those with high technical and capital requirements. However, because of the sensitive political nature of foreign investment in Mexico, officials have repeatedly stressed that the restrictive law will not be changed.

Despite this stance, some substantive changes have been taking place through specific industry regulations. Mexico issued two new foreign investment regulations in 1986—Resolution 14, making multilateral and government development bank capital neutral, and Resolution 15, which makes foreign majority investment by small and medium-sized foreign companies easier. Mexico did not follow through with a change in foreign equity requirements in the autoparts and secondary chemical industries as expected.

Minor modifications were made in foreign investment resolutions in 1984 and 1985, and in 1984 the authorities took the unprecedented step of spelling out conditions under which officials may authorize majority foreign ownership of new or existing ventures. Approval from the Foreign Investment Commission (FIC—comprising seven cabinet secretaries) is needed for new investments with more than 49% foreign ownership. Recently modified resolutions extended the decisionmaking power of the FIC's executive secretary, who is now authorized to approve foreign purchases of stocks, and will do so as long as the purchase does not increase foreign ownership to over 49%.

The 1985 rules also stated that certain new establishments—including administrative offices, job-training centers and parking lots—may be added without FIC approval, and relocations to priority zones that involve an expansion of up to 100% also do not require approval. In both these cases, companies must notify the executive secretary within 30 days. The executive secretary also has broad leeway to rule in cases that involve "significant exports," but sensitive decisions still must go to the full commission.

The commission staff and its executive secretary form part of the Under Secretariat of Foreign Investment Regulation and Technology Transfer, which, in turn, falls under the authority of the Secretariat of Commerce and Industrial Development (Secofi).

1.06 Amount of foreign investment. Accumulated direct foreign investment more than doubled from $5.3 billion in 1976 to $10.7 billion by the end of 1982. Officials authorized $1.6 billion in majority foreign-owned investment in 1986, bringing total foreign investment to $16.9 billion. Existing companies with foreign participation received approval to hike investments by $700 million last year, for a total of $2.3 billion in new foreign investment. A considerable portion of these investments includes debt-equity conversions and authorization for new product lines, most of which were financed with internally generated funds. The authorizations also cover investments approved but to be paid in over a period of several years.

Because of a drop in investment by Mexican public and private sectors by end-1986, foreign investment had risen to 9.6% of total investment in both the public and private sectors, compared with 4.5% the previous year. Of the 7,191 companies with foreign capital participation, 4,283 involve minority foreign equity, while 2,908 are majority foreign-owned. Foreign investment is concentrated in the economy's most dynamic areas, such as the automotive and farm machinery industries, secondary petrochemicals, electronics, metals, pharmaceuticals, and paper- and food-processing. As of late 1986, some 77.4% of foreign investment was in manufacturing, 11.5% in the trade sector, 11.1% in services, 4% in mining and 0.3% in agriculture.

The US supplied the biggest share of foreign investment, 66.8%, in 1986; Japan, 12.5%; the UK, 4.4%; Germany, 3.4%; and Switzerland, 3%.

1.07 Examples of foreign investment. Debt-to-equity conversions have become the most important new vehicle for foreign investment in Mexico. All of the major automakers have made such deals in recent months, including Nissan ($95 million), Chrysler ($70 million), Ford ($50 million), Renault ($15 million), Daimler-Benz ($4 million) and Volkswagen ($30 million.). Other industrial companies that have capitalized via debt swaps include Kobe Steel, Singer, Corning and Purina.

During the year, the FIC also approved 65 out of 66 applications to move from minority to majority foreign investment. SKF, for instance, has taken a majority position in Puebla-based Ibisa to manufacture ball bearings in return for a strong export commitment. Hewlett Packard won approval for 100% ownership of its personal computer manufacturing operations. Apple Computers also won approval to go to 100%.

Other investments include $250 million invested by Nippon Steel, Mitsubishi and Mitsui in the Lazaro Cardenas-Las Truchas steel complex. Nestle won approval for an investment of $12.2 million over three years to expand instant coffee production, new product development and installation of waste water treatment facilities. Club Med invested $40 million through a debt swap to finance completion of a vacation village in Bahias Huatulco. Other tourism investments included the following: Banco Arabe Espanol (ARESB) invested $93.4 million through a debt swap for four hotels in 1986—two in Cancun, one in Los Cabos and one in Puerto Vallarta. ARES Bank also invested $35 million in 1987 for another hotel in Cancun; Petit Laboratories invested $12 million for expansion; American Express Bank invested 60% of a $22 million investment with Club Med and government development banks for a hotel in Huatulco; and Kimberley Properties Ltd invested $30 million for a hotel named the Oasis in Cancun.

In early 1987, 45 new permits were issued for secondary petrochemicals manufacture. Thirteen of these projects involve joint ventures with foreign participation. Among them is a joint venture between E.I. du Pont and Reactivos Minerales Mexico to produce sodium cyanide. A total P27 billion investment is planned. Naamloze Venootshap (the Netherlands) and Celanese Corporation will participate with Univex in a P21 billion investment to expand caprolactame production.

1.08 Profitability of foreign investment. No figures on the profitability of foreign-owned subsidiaries in Mexico are readily available. However, according to the latest available data from the US Department of Commerce, US companies earned a 14% return on the book value of their Mexican investments in 1985 (latest year available). Manufacturing income rose 121% to $716 million.

1.09 Official sources of business information. Information on doing business in Mexico is available from Banco de Mexico (the central bank), located at Cinco de Mayo No. 2, 06059 Mexico DF (Tel: 905-518-0500); Nacional Financiera (Nafinsa), Venustiano Carranza 32, Col Centro 06000 Mexico DF (Tel: 905-518-0060); and the Secretariat of Finance and Industrial

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Development (Secofi), Alfonso Reyes No. 30, Col. Condesa, 06140 Mexico DF (Tel: 905-211-0036).

1.10 Other BI sources of information. Readers interested in further information on Mexico available from Business International should consult the weekly publication *Business Latin America,* the *Latin American Forecasting Study,* and *ILT*'s companion reference service, *Financing Foreign Operations.*

Other BI publications that offer in-depth information on Mexico include the following: *Cross-Rates* covers the Mexican peso with a quarterly forecast; *Executive Living Costs in Major Cities Worldwide (BI/COL),* updated twice each year, surveys cost-of-living data in 89 cities throughout the world; and *BI Position Evaluation and Remuneration Service (BI/PERS)* offers reliable information on local remuneration practices in 25 countries. A BI study, *Reassessing Mexico: Strategic Questions for an Uncertain Market,* is also available, as *How to Use Mexico's In-Bond Industry.*

In addition, BI's research departments in New York, London and Hong Kong are prepared to handle individually tailored research on topics of special interest to *ILT* readers. Such research is conducted on a fee-paying basis; a prior cost estimate will be furnished upon request.

2.00 STATE ROLE IN INDUSTRY

2.01 General. The state plays an enormous and expanding role in Mexico's industry, through either independent state-owned entities (*organismos decentralizados*) or mixed public/private companies (*empresas con participacion estatal*). The latter are supervised by such state agencies as the Secretariat of Energy, Mines and Parastate Industry (Semip), the Secretariat of Commerce and Industrial Development (Secofi) and Nacional Financiera (Nafinsa). Many mixed companies are in direct and intense competition with private firms, even down to the retail level.

Government involvement now ranges from investment in the oil and electricity industries, which came under state control in the 1930s, to such sectors as steel and other metals, basic petrochemicals, fertilizers, vehicles, railway equipment and forestry. The banking system is the most recent addition to the public sector fold. The public sector's share of total investment is estimated to be well over 50%.

The shortage of resources since 1982 has forced the government to wean itself of nonstrategic enterprises. Out of the 898 companies and trusts operated by the government in 1982, 459 have been authorized to be liquidated, sold or transferred to state governments. To date, however, the government has only disposed of 178. Out of 96 firms put up for sale, 72 have actually been sold—most in the industrial and tourism sectors. Out of 259 firms that are to be liquidated, merged or transferred to the states, only 106 have actually been dealt with. In all, 30 firms are expected to be eventually transferred to the states. Some 64 firms will be merged, 269 will be liquidated and 96 are to be sold. In March 1986, the government announced it was liquidating an additional 43 companies or trusts and transferring or consolidating 16 others. Critics charged that too many of the liquidated entities were obsolete trusts bound for extinction anyway and not the real deficit-generating losers. However, the administration's decision in June 1986 to shut down the Fundidora Monterrey steel plant and shutdowns later in the year of Aceros Chihuahua, Aceros Ecatapec and Aceros Industriales, which affected 13,661 workers, show a growing resolve to deal with politically sensitive parastates.

The state's growing role as a planner is underlined by the far-reaching extent of its sectoral development plans, and it also directly affects industrial activity through the purchasing power of large parastate companies such as Pemex, Fertimex and the Federal Electricity Commission (CFE). The current administration has also strengthened the economic participation of the so-called social sector, comprising organized labor.

2.02 State-owned industry. Sectors reserved for the state are banking, petroleum and other hydrocarbons, basic petrochemicals, radioactive materials and nuclear energy, electricity, certain mining areas, railroads, and telegraph and wireless communications.

Pemex has a monopoly over Mexico's oil exploration, production, refining, marketing and distribution. It also controls the basic petrochemicals industry. Sidermex, a holding company formed in early 1978, controls the government's majority interest in the steel companies Altos Hornos de Mexico (Ahmsa) and Siderurgica Lazaro Cardenas Las Truchas (Sicartsa).

Combinado Industrial Sahagun was formed by Diesel Nacional (Dina—manufacturer of buses and trucks), Constructora Nacional de Carros de Ferrocarril (railroad cars) and Siderurgica Nacional (special steel machinery and motor blocks). Furthermore, the state has smaller participations in many manufacturing companies in such fields as automobiles, chemicals, steel, appliances and food.

Nafinsa, the government development bank, currently holds equity in a number of companies. It tends to buy and sell, however, recirculating its holdings. Nevertheless, the total number of companies has remained constant at 64–65 since 1982. During 1986, it sold its shares in Alimentos Fuerte, Avantram Mexicana, KSV, San Cristobal paper mill, Industrias Penoles, Centrifugas Bridbent Interamericana, Glicoles Mexicanos, and Productora Mexicana de Farmacos. New investments have been centered on the mining, steel, copper, chemicals, petrochemicals and basic goods sectors. New investments include Refineria Cobremex (copper refinery) and Alfa Cedlulosa de Mexico (chemical cellulose for export). A project to produce sulphuric acid is slated to receive $55 million.

Nafinsa's other holdings include Grupo Pliana, Mexinox (with France's Pechiney Ugine Kuhlmann as minority partner and Fundidora de Mexico and the International Finance Corporation also holding some shares); Dina-Komatsu (in which Komatsu of Japan has a stake); and Dina Rockwell (in which Rockwell of the US participates). Nafinsa also holds a 33.5% stake in Grupo Industrial NKS SA de CV, a joint venture with Sidermex and Japan's Kobe Steel.

Grupo Somex, a state-owned banking and industrial conglomerate, once had a dozen or so profitable joint ventures but now is divesting most of its portfolio. It now focuses on tourism and real estate for low-income housing construction. It has sold its autoparts division, which included shares in Motodiesel (sold to Dina), Atsugui Mexicana (oil pumps) and Mex Par (breaks and radiators). It has also sold its home appliance and capital goods divisions and is reducing its petrochemical division with the sale of Cloro de Tehuantepec.

2.03 Nationalization policy. Expropriation is regulated by Art. 27 of the Constitution and by the Law of 1936, which requires court approval and adequate compensation for takeovers made for reasons of "public convenience." Owners have the right to appeal, especially by invoking the *recurso de amparo,* which guarantees the individual rights of all Mexican residents. Mexico takes both the right of appeal and the "adequate compensation" stipulation seriously.

The most dramatic recent example of expropriation followed the September 1985 earthquakes, when the Mexico City government took over several hundred properties. This was intended as a populist move—the properties were to be used for low-cost housing—but it created a number of political problems and legal entanglements.

In September 1982, outgoing President Jose Lopez Portillo nationalized the banking sector (11.01). Shareholders were paid through government-secured indemnization bonds with 10-year maturities. These bonds are negotiable on the stock market. Citibank, the only foreign private bank with full operations in Mexico, was exempted from the nationalization decree, as was the workers' bank, Banobrero.

3.00 ORGANIZING

3.01 General. The Mexican government has traditionally exercised tight control over foreign investors through various legal and administrative mechanisms, which have included local-content requirements, price controls, ceilings on foreign equity, tax concessions, withholding of import licenses and, recently, access to foreign exchange at favorable rates.

Since 1973, the backbone of government control has been the Law for the Promotion of Mexican Investment and the Regulation of Foreign Investment, which limits the amount of equity foreigners may hold and the fields in which they may invest (3.03). The law also instituted the Foreign Investment Registry. Unregistered foreign investments are not recognized under Mexican law. The foreign investment law is administered by an interministerial committee, the National Commission on Foreign Investment (FIC), which comprises representatives from the secretariats of the Interior, Foreign Affairs, Treasury, Labor, Budget and Programming, Commerce and Industrial Development (Secofi), and Energy, Mines and Parastate Industry.

Other laws that apply to foreign investment include strict rules on the transfer of technology (6.03) and limitations on the employment of foreign nationals (12.07). The de la Madrid team has consolidated the Office of Technology Transfer and the Office of Patents and Trademarks into one administrative unit, the Department of Technology, Development, Patents and Trademarks; it has transferred control of this new unit from the FIC to Secofi. Firms seeking special concessions, such as tariff protection or fiscal incentives, must secure additional approvals.

3.02 Basic approval procedure for new investments and expansions. The most important approval required is that of the FIC, which consults with various government departments before giving foreign investors the go-ahead. Expansions and new investments by established firms must also be sanctioned (3.04). Even when prior FIC approval is not explicitly required—such as when a firm seeks Mexicanization—companies are urged to obtain the go-ahead from the FIC immediately.

From 1983 to 1986, the FIC approved 84% of the applications it considered. In 1986, 330 applications were made; of those, 302 were authorized and 28 rejected. Rejections centered on requests for majority ownership in the autoparts and secondary chemicals area and requests to set up service companies that already had Mexican majority firms in the sector. The most frequent reasons for rejection are the displacement of domestic producers, conflict with priority sectors of "national interest," insufficient integration of locally made inputs, insufficient benefits in the form of export revenues, or a burden to a sector's balance of payments. Foreign investors that comply with the government's regional and sectoral priorities generally receive favorable treatment.

The FIC has also rejected applications that comply with some but not all of the government's goals. IBM was originally denied majority ownership on a new product line of microcomputers, the bulk of which was to be exported. Officials considered the venture's local-content level, total investment and job generation insufficient. They also felt that the company did not offer attractive enough concessions to make an exception to that industry's development program, which requires Mexicanization of new investments.

However, IBM went back to the bargaining table with the FIC and won approval for a 100%-owned PC-manufacturing facility. The computer giant sweetened its offer considerably, especially in the areas of local content and total new investment. The company also has committed substantial funds to developing local suppliers and distribution networks, as well as developing university programs. The approved proposal also called for 820 more direct and indirect jobs than the rejected version.

While protection of local industry is a major reason for negative rulings, officials claim that under certain circumstances they will allow for a foreign-owned venture if similar local industry is inefficient. For that reason, a machinery and tool manufacturer was allowed to set up a wholly foreign-owned operation to compete with the Mexican monopoly, which produces similar but obsolete goods at a high price.

After receiving FIC approval, foreign firms must also obtain a permit from the Secretariat of Foreign Affairs, which authorizes the acquisition of property, and must then register the investment with the National Registry of Foreign Investment. Both steps are routine and can be accomplished in a matter of weeks. Mexican nationals acting on behalf of foreign interests must also register with the National Registry. Stiff penalties apply to any Mexicans acting as *prestanombres*—"name lenders"—who serve as front men for foreign capital.

The foreign investment law's resolutions, which were revamped in 1984 and 1985 (1.05), set a 30-day time limit on decisions by the executive secretary and fix the same period after submission of proposals to the full commission. However, requests for further information frequently extend the 30-day limit. The new resolutions also empower the executive secretary to rule on the opening of new establishments in cases involving "significant export volume"—allegedly meaning most of a firm's output. FIC authorization is no longer required in the following cases:

- Sale or transfer to other 100% foreign-owned companies of in-bond plants with at least 75% foreign capital.
- Appointments and replacements of foreign board members.
- Transfer of shares or fixed assets between foreign investors.
- Opening of new or relocation of existing establishments "if significant export volume" is involved.

3.03 Activities not open to foreign capital. Mexico prohibits foreign investment in banks, the petroleum and primary petrochemicals industries, radio, television, urban road transportation, air and sea lines, forestry, gas distribution and other areas reserved for the state (2.02).

3.04 Limitations on foreign equity. The 1973 foreign investment law limits foreign equity and foreign management control in new Mexican ventures to 49% except under special circumstances. The law does not apply to in-bond facilities, which may be 100% foreign-owned (13.05). Secondary petrochemicals and autoparts ventures are currently subject to a 40% ceiling on foreign equity. Since 1984, pyramiding has been allowed in the Mexican autoparts industry, but Mexico did not move as expected to allow full 100% foreign ownership in 1986.

Established ventures may continue under majority foreign ownership, as long as they make no new investment—defined as that which requires substantial new capacity, introduces a new product line or is located in a new place. However, the law's wording leaves plenty of latitude for the FIC, which can apply the rule liberally or strictly when deciding about a new model of an existing product or the introducion of a new line closely linked with established ones.

Resolutions passed in 1984 and 1985 (1.05) allow companies to open new administrative offices, facilities for worker training, employee recreational facilities or parking lots for company use. Firms must simply inform the FIC executive secretary within 30 days of undertaking various expansions. These include setting up showrooms, service and advertising facilities for their own products and establishing warehouses for finished and semifinished products and raw materials, as long as the company actually owns the warehouse.

Simple notification of the executive secretary is also the only requirement when foreign investors want to set up representative offices that do not earn income, temporary offices (e.g. to conduct negotiations or oversee projects) and representative offices to conduct market research for future investments—as long as Mexican nationals are employed by the last. The same notification procedures apply to manufacturing companies' relocations that involve increases of up to 100% in actual productive areas and of higher percentages in personnel and fixed assets if the move is to a less-developed area, preferably Zone I (10.00). For administrative, commercial, service and other establishments moving to less developed areas, subsequent notification is sufficient for a 20% increase in physical space, personnel and assets.

Capital increases do not require approval if the proportions of foreign and Mexican equity are preserved. The executive secretary may authorize foreign shareholders to subscribe the full amount of capital increase provided they previously owned 51% of the capital in the company and the Mexican shareholders explicitly declined their right to participate in the capital increase.

The new equity must be financed by new investor contributions to avoid need for FIC approval. Financing of new capital through debt capitalization or reinvestment of profits requires FIC approval. The executive secretary must also approve the purchase of the 25% Mexican shareholding if 75% of the shares are held by a foreign partner. Capital increases or purchases of shares that would reduce a majority Mexican shareholder to a minority position still require approval. The executive secretary may permit foreign investors to acquire shares owned by Mexican investors as long as overall foreign investment in the company does not exceed 49%.

Transfer of shares or assets among foreign investors requires no authorization as long as it does not involve debt capitalization or reinvestment of profits. The purchasing party must attest before the executive secretary that all relevant obligations and commitments undertaken by the selling party will be respected.

A 1981 modification of the foreign investment law tightened rules against pyramids and holding companies. FIC authorization must now be obtained for any purchase of stock in a Mexican firm by a holding company with foreign capital participation if the purchase results in net foreign ownership of 25% or more. The text of the new resolution was vague and did not refer to existing pyramided investments, but it did specify that FIC authorization is necessary for purchases that initiate, maintain and increase net foreign ownership of 25% or more. Restriction on pyramiding appears to be waning in the de la Madrid administration. A 1984 autoparts law amendment allows it, and similar treatment is expected to be approved for mining and cement.

Equity limitations have also been affected by Resolution 14, issued in 1986. Resolution 14 classifies investment by multilateral banks and government development banks as neutral capital. Such equity must be sold within 10 years.

Resolution 15, also issued in 1986, allows small and medium-sized firms to make majority investments, relocate establishments or engage new lines of activity in Mexico without prior FIC approval. Net annual sales of the parent company cannot exceed $8 million. Total employees must not exceed 500 persons. The Mexican operation must be in the manufacturing sector and not employ more than 250 persons. Sales may not exceed the indexed equivalent of P.1 billion. In addition, the firm must export 35% of its production and maintain a surplus in its trade balance and equilibrium in its payment balance. Plant location must also conform to decentralization criteria.

In early 1984, the commission released a list of specific industries in which it might authorize majority foreign ownership of new or existing ventures (see the box on p. 8). Authorities stress that new ventures should be self-sufficient in foreign exchange, unless they contribute directly or indirectly to substitu-

Mexico's Favored Industries

Foreign investment officials may authorize majority foreign ownership in the following industries:

Nonelectric machinery and equipment
Agricultural machinery and tools; woodworking machinery; machinery to process and package foodstuffs and beverages; machinery for the petroleum and petrochemical industry; numerically controlled tools to cut and shape metals; textile machinery; plastic moulding machinery; machinery for the graphic arts industry; cranes, pulleys, etc.

Electric machinery and apparatus
High-powered electric motors and generators; turbines for the processing industry; high-powered turbo compressors.

Metal-mechanic
High-technology metallurgy; high-precision microsmelting; specialized tools.

Electronic equipment and accessories
Telecommunication equipment; magnetic discs and tapes for the data-processing industry; data-processing equipment and components; process-control equipment; various electronic materials and components; electronics, scientific and engineering equipment; consumer electronics.

Transportation equipment
Motorcycles of more than 350 cc; internal-combustion motors for vessels and locomotives; equipment to construct and repair vessels.

Chemicals
Active pharmaceutical substances; plastic and synthetic resins; specialized goods.

Others
Measurement tools; medical equipment; photographic equipment and inputs for the photographic industry; new high-technology materials; biotechnology equipment; construction and management of hotels.

tion of imports. In 1986, the FIC began relaxing its stress on local content and instead emphasized a strong export program, surplus trade balance and research and development work.

A company seeking an equity position of more than 49% may apply for special FIC authorization. The commission will raise the limit if it thinks the move is in Mexico's interest. (Applicants may consult with FIC authorities in advance on the merits of the investment and about whether they can realistically expect to receive permission for more than 49% equity.)

As with applications for expanding foreign-majority companies, the commission scrutinizes the economic benefits of a proposal in terms of Mexican development goals. The FIC claims to offer exceptions on the basis of the technology offered, conditions in the relevant local industry, the venture's export potential, contributions to import substitution and individual considerations.

Although a number of existing companies have been allowed to capitalize debt to obtain a majority foreign-capital structure, authorities look at this as a last resource. They prefer capital injections through preferential credits of industrial trust funds or co-investments with Mexican development banks. Firms that apply for debt-equity conversion must submit detailed information about the nature of their indebtedness, their overall financial position and the amount of profit remittances, royalty and interest payments made over the previous six years. If a firm is presently registering profits, the conversion will be automatically rejected.

Authorized companies are virtually always required to re-Mexicanize within the period the firm is expected to become profitable again. Shares must be placed in a trust, and in some cases the value of the stock at the selling time will be determined by applying to the stock value each year a percentage based on CPP (Mexican banks' cost of lending—93.76% as of May 1986) plus several points.

A 1975 mining law introduced an important "net capital" concept by which the government prorates the foreign equity of majority Mexican-owned firms in calculating the net foreign participation in a new venture with a foreign-owned firm. For example, if a 60% Mexican-owned firm takes 60% equity in a new venture with a wholly foreign-owned firm, the resulting venture is considered 36% Mexican (60% of the 60% Mexican equity in the first company). The same system of calculating equity is used for most other sectors, although in the autoparts sector, for example, it is possible for a foreign partner with a minority share to have effective control through pyramiding.

3.05 Building and related permits. Various approvals must be obtained before any actual building can commence. During the foreign investment approval process, specifications for new plant must be submitted to the Secretariat of Commerce and Industrial Development, which consults with different government departments on various points (e.g. zoning, environmental protection). Foreign investors should request specific approval from each government department at the same time.

The Public Works Divisions of the various state governments or the federal district authorize building permits. Extensive water use must be approved by local water officials, and pharmaceutical or food-processing plants must obtain Health Department permission before beginning construction.

Detailed environmental regulations covering water, dust and smoke pollution are in effect. Environmental matters in general fall under the Department of Public Health, and the Department of Water Resources decides on questions involving water pollution control. Officials are beginning to request detailed environmental-impact studies for large projects.

It usually takes slightly more than a month to obtain each required permit.

3.06 Acquisition of real estate. With the approval of the Secretariat of Foreign Affairs, foreign companies are free to acquire land, including sites in industrial parks. However, foreigners may not own land within 100 km of Mexico's borders or 50 km of the coastline without special permission. If an industrial or tourist project is planned in a border or coastal area, foreign investors may secure the land they need through a *fideicomiso* (trust arrangement), under which local banks hold the land in trust for a maximum of 30 years.

3.07 Acquisitions and takeovers. The 1973 foreign investment law made acquisitions extremely difficult. A foreign company must obtain authorization from the government before acquiring more than 25% of the equity or more than 49% of the fixed assets in established ventures. Moreover, Mexican investors have a 90-day period, subject to renewal for a like period, to make the purchase instead. The FIC occasionally approves foreign acquisitions, particularly to rescue ailing companies, but this remains one of the most tightly regulated areas of investment. The executive secretary of the FIC is empowered to approve acquisitions up to 49%, but majority acquisitions must have full FIC approval.

The 1975 mining law applies a "net capital" requirement to acquisitions of majority foreign-owned companies by minority-owned ones (3.04). That concept was extended to all companies by the resolution concerning holding companies.

3.08 Local-content requirements. Tougher, more closely enforced local-content requirements have been imposed on many industries. For example, the 1983 decree for the rationalization of the automotive industry increases local-content requirements, computed as import content divided by total value of a typical unit, on a vehicle-by-vehicle basis. Automobile manufacturers were required to increase the level of local content to 55% in model year 1986 (vs 50% in 1985), and to 60% in 1987. Local-content requirements for vans and light trucks were hiked from 65% in 1984 to 70% in 1985. Medium and heavy trucks were required to gradually increase their local content from 65% to 80% by 1987, while tractor trailers and buses had to reach a 90% minimum local content in 1985.

Local-content requirements for new lines designed primarily for sale abroad depend on export targets and range from 0% to 29% for lines exclusively sold abroad to as much as 50% local content if exports represent less than 60% of total production. For autoparts manufacturers, 80% of total production must be from locally made inputs. Each individual product line had to have at least 50% Mexican content through 1985, 55% by 1986 and 60% by 1987. In addition, by 1986, at least 50% of the domestic content required of a given production line had to arise from Mexican-made auto parts. Local-content requirements for automobiles also apply to engines.

Officials expect to increase overall local input of raw materials for the pharmaceuticals industry from 43% in 1985 to 64% in 1988. New raw materials had to include at least 20% local content in the first year, to be hiked to 50% in three years, or in five years if permission is given.

Local content is also used to determine eligibility for public sector sales put to bidding. A company whose products have 50% domestic content is considered Mexican, and as such it can participate in tenders limited to local firms. The whole local content issue will, however, have to be reviewed in light of Mexico's entry into GATT, since GATT calls for no discrimination between local and foreign content.

3.09 Mandatory memberships. Every business in Mexico must belong to at least one of the many local chambers of commerce and industry. The cost is usually small, and the obligations are limited. Some foreign-owned firms active in their chambers have found the organizations useful for keeping informed and for influencing colleagues (and, indirectly, the government) in matters affecting their business. Lobbying through the chambers is particularly important at present, as the government modifies its price-control mechanisms sector by sector and further liberalizes trade. The chambers' functions include the monitoring of bids for major government purchases. Chamber members are notified of imminent purchases and are among the first to receive specifications.

3.10 Establishing a local company. Mexico has all the usual forms of business organization, including the *sociedad anonima* (corporation) and the *sociedad de responsabilidad limitada* (limited-liability company). Several other forms of organization (e.g. *sociedad en nombre colectivo, sociedad en comandita por acciones*) are suitable only for small operations.

The permit for establishing a company stipulates that the Calvo clause be inserted in the bylaws and on stock certificates. This clause waives the right to invoke foreign diplomatic intervention and foregoes any claim to treatment different from that accorded to Mexican nationals.

The *sociedad anonima* (SA) and the *sociedad anonima de capital variable* (SA de CV) are the most common forms of organization for foreign investors. The SA most closely resembles the public limited company or corporation (see the box below). The SA de CV, or corporation with variable capital, has been favored by foreign investors with wholly owned subsidiaries that want the added flexibility for increasing or de-

Requirements of a *Sociedad Anonima* In Mexico

Capital. Minimum P25,000. At least 20% must be paid in initially. Shares payable in kind must be paid in full immediately and remain on deposit with the corporation for two years; if the assets represented by the shares decline by more than 25% in value during that period, the shareholder must pay in the difference. Firms must place 5% in a legal reserve until the reserve equals 20% of authorized capital.

Founders, shareholders. Minimum five founders and shareholders (four may hold only one share each).

Board of directors. Minimum two. A minority that holds 25% or more of stock has the right to appoint one director. Foreigners may be appointed to the board only in direct proportion to the authorized foreign capital participation in the company. There are no residency requirements for board members.

Management. One individual manager may be appointed. There are no nationality requirements.

Labor. No requirement that labor be represented on the board. Firms must distribute 8% of pretax profits to employees.

Disclosure. Corporations must be supervised by examiners, who are appointed at a stockholders' meeting (25% minority can name additional examiners). No publication requirements (except for companies listed on the stock exchange—11.04).

Taxes and fees on incorporation are minor, but legal fees may be substantial.

Types of shares. Only nominative shares are permissible. For purposes of Mexicanization, shares are often classified as "A" and "B," one of which is restricted to Mexican nationals. Special labor shares may be issued for personal service. Founders may receive up to 10% of the corporation's profits every year during the first 10 years of existence by means of founder bonds, provided the shareholders have received at least a 5% dividend each year. There may be preferred and common stock. Preferred stock must have limited voting rights (only concerning actions to transform, merge, dissolve or make other such major changes) and must receive a cumulative dividend (usually 5%, sometimes less) before the common stock can participate in the corporation's profits.

Control. Simple majority of stockholders has control, unless charter calls for higher majority (e.g. 60–80%), as is frequently required for major decisions. Annual general meetings required; representatives of half the corporate capital constitute a quorum. For extraordinary meetings (for major changes in corporation), 75% of capital necessary for quorum on first call (50% thereafter). Decision is by simple majority.

creasing capital. Procter & Gamble, Ralston Purina, Johns-Manville, Kimberley-Clark, Union Carbide and Singer (all US), ICI (UK) and Sandvik (Sweden) are among the companies using this form of organization. All shares must be nominative.

Organizing a local corporation may take six weeks or longer, depending on the complexity of the project. A permit must first be secured from the Secretariat of Foreign Affairs (3.02). A minimum of five persons must then appear before a notary public to sign the deed of incorporation, which must contain the names, nationalities and other particulars of the founders; the name, domicile, purpose and duration of the company; a breakdown of its capital and a statement of the founders' contributions and their value; a description of the manner of administration; names of directors, managers and supervisors; the manner of liquidation; and all other special agreements that will regulate the operation.

3.11 Establishing a branch. A few companies have set up branches, but branches are at a disadvantage for several reasons: They are not well-regarded by Mexican authorities; they cannot own real estate; they cannot deduct payments to the parent for royalties, interest, fees or other services; and they must pay a 55% dividend withholding tax on their income after corporate tax, whether or not such income is remitted. Furthermore, establishing a branch takes more time and money, and charters for branches usually contain more restrictions than those for corporations. Mexican authorities have not yet determined the exact requirements for establishment of branches under the 1973 investment law. Establishing a branch is definitely more time-consuming. Many foreign firms prefer instead to set up a local Mexican majority company. It is easier, and the company is subject to less government scrutiny.

4.00 RULES OF COMPETITION

4.01 General. Mexico has no specific antitrust law, although there are constitutional provisions against price fixing and other monopolistic practices. The government's moves to curtail trade restrictions and to gain GATT membership will put external pressure on domestic monopolies. The government sometimes tries to promote competition by fostering several firms in the same industry, even if the market does not warrant it. In the tractor industry, for example, the government opened the market to Massey-Ferguson and Ford, even though John Deere and International Harvester had understood that it was to be reserved to them. As a result, all four companies suffered from the lack of business and customers. Massey-Ferguson, in fact, sold out to Grupo Alfa in 1980. Alfa, in turn, sold this subsidiary to Fabrica de Tractores Agricolas (FTA), a joint venture in which Ford holds a 40% stake.

4.02 Monopolies and market dominance. Monopolies are not subject to legal limitations unless they violate price controls (5.00). The National Development Plan stresses the government's commitment to strengthen small- and medium-scale industries through priority treatment—including preferential credits, technical assistance and tax incentives. Large conglomerates will probably continue to flourish because Mexico needs their industrial strength, but they are not looked upon favorably. Foreign investors are encouraged to team up with small Mexican concerns whenever possible, rather than with the local conglomerates—which, in any case, are relatively few.

4.03 Mergers. Mexico has no specific legislation covering mergers. FIC approval is needed for mergers that would alter the balance of equity ownership. An informal FIC ruling is necessary when two foreign-owned companies contemplate a merger. Under the 1985 pharmaceuticals decree, foreign-owned firms are not allowed to acquire existing operations in the industry. Majority Mexican-owned companies, however, are encouraged to merge.

4.04 Freedom to sell. Mexico seldom prevents manufacturers from selling to whomever they wish. Exceptions include provisions in the 1975 mining law that require coal and sulfur producers to distribute their products according to government specifications and some restrictions on exports of products deemed necessary in the domestic market.

A 1975 consumer protection law set guidelines for advertising, consumer credit and packaging. Companies are prohibited from packaging or advertising in foreign languages to the general public. Advertising aimed at children is closely scrutinized, and companies are expected to meet legal standards when backing guarantees and servicing products. Promoting a product of "export quality" or "at export prices" is forbidden.

Regulations issued in 1980 revamped much of the 1975 consumer protection law. Under the revised rules, companies must have approval from the Secretariat of Commerce and Industrial Development (Secofi) for promotional campaigns offering free items, such as two items for the price of one. (In such instances, the final sales price must be lower than the items' combined market value.) Moreover, promotions based on collecting a series of coupons, etc., are now generally prohibited unless firms can show some benefit to consumers. Secofi no longer approves campaigns requiring complicated or unclear procedures to obtain bonuses.

The government's two television stations stopped broadcasting liquor advertisements in 1981. Privately owned stations can air ads for beverages with an alcohol content over 13% only after 10 PM. As of July 1, 1984, the labels of all alcoholic beverages have had to include a warning stating that alcohol abuse damages health.

A variety of foods and other necessities require labels with a list of ingredients, the maximum price or both (5.00). Companies should now expect greater emphasis on nutritional content.

4.05 Resale price maintenance. Although there are no regulations either permitting or prohibiting the practice, it is very difficult to control resale prices in Mexico.

5.00 PRICE CONTROLS

Over the course of 1986, Mexican officials revamped the existing three-tier price surveillance system to ease cost pressures on producers and to make the system generally more flexible. The three tiers are as follows: (1) products for which prices will remain frozen until the authorities find it necessary to modify them; (2) products for which companies may apply for price hikes when their costs have risen; and (3) products subject to price registration. Officials have not published a product classification list.

Prices on **Category I** products are set by the government after industry-wide negotiations. This group includes all basic foods, drugs and many primary industrial materials. Secofi and the industry chamber jointly select a prototype company and track the firms costs to determine when an increase is necessary. Companies with goods in Category I note that the new system has resulted in quicker price adjustment, averaging about 90% of the rise in the official COL index.

Category II products are on system known as the *Registro Controlado*. Here a company and Secofi work out a schedule for periodic increases at an annual percentage of the inflation rate—usually 90% of inflation. Once the rates of increase are agreed on, the firm automatically increases prices by the agreed amount and on the set time schedule. It then submits its new price list to Secofi, which has five days to halt the increase if it finds the firm has gone beyond what was agreed to. If a company finds that its input price increases are much higher than the norm, it can put in a request for a special increase. This is most common with companies that have a high percentage of imported inputs.

Recently, Secofi has been willing to consider moving some products out of Category I. For instance, in the canned vegetable industry, the chamber has argued successfully that canned vegetables should be moved to Category II, since the cans used in packaging are in Category II and this way price increases can be simultaneous. A chemicals producer was also successful in getting phosphates, phosphoric acid and purified phosphoric moved from Category I to Category II.

Prices on **Category III** goods are merely reported to Secofi. This is called the tracking system. Firms are free to raise prices as desired but must submit a cost analysis every six months. The auto industry was put on this system in mid-1986 and since then a wide range of appliances have been moved into this category.

Secofi has also started experimenting with a new technical coefficient based price increase mechanism. It is being tested on the detergent industry. Under the system, a technical coefficient taking into account input costs, technology and production costs is determined for each firm. When the coefficient increases by more than 5%, a price increase is automatically granted. The decision is supposed to be made within five working days once the request is made. Detergent producers say the time period is usually from 10 to 30 days but that this is better than the 30 to 60 day waits in the past.

In 1979, Secofi issued requirements that selected products be labeled with maximum selling prices and/or a list of ingredients according to percentage of importance. The list of products affected by the measure, more than half of which are under price controls, is broken down into the following categories:

(1) Label must show ingredients and maximum price. Prepared baby foods; canned chiles; soluble coffee; detergents; canned fruits and vegetables; cookies; vegetable fats and oils; laundry and personal soaps; condensed, evaporated and powdered milk; infant formula; toothpaste; ground and refined salt; sardines in containers; and wheat flour pastas.

(2) Label must show ingredients. Canned tuna; prepared cereals; processed condiments; powdered and table chocolate; snacks and candies; fruit jellies and marmalades; mayonnaise; mustard; packaged bread; canned soups; and vinegar.

(3) Label must show maximum price. Purified water; rice; oatmeal; raw and refined sugar; roasted and ground coffee; beef; all varieties of beans; wheat flour; corn flour; eggs; milk; fresh, refrigerated, frozen or dehydrated fish; bottled soft drinks; and corn tortillas. Labels of all products included in the basic pharmaceutical basket must display the generic name of the medicine's main ingredient and its sanitary code number in the same size and letter type as the brand name. Labels must also clearly display the official price.

Mexico's price control regulations state that a company whose application for a price increase has not been answered within 30 working days may assume that approval has been officially granted. If the authorities ask for more information within 10 days of receiving a request, the company has 60 days to submit the additional material, and the authorities have another 20 days to give a final answer. In practice, 60 to 90 days elapse between the time of application and the actual authorization of the price hike, although some firms have had to wait up to six months before an increase was approved. During this period, Secofi grants provisional increases based on the cost of raw materials, packaging and increases in labor cost.

Pharmaceuticals regulations issued in February 1984 reinforced government control of the prices of drugs. Generic labeling for all products with a main ingredient included in the basic basket of some 480 drugs is now compulsory, and officials will gradually set uniform prices for the generics. Secofi has also set reduced prices for 27 essential medicines, leaving producers and distributors minimal margins on some number-one sellers. Officials claim they will take into account the higher raw-material costs of franchised drug manufacturers when fixing price ceilings.

In 1986, prices of basic foodstuffs were hiked by 108.7% against inflation of 105.7%, mainly as a result of efforts to cut government subsidies. The price of tortillas increased 250.2%, bread 118.1% and eggs 117.1%.

6.00 LICENSING

6.01 General. Mexico's 1982 transfer of technology, patents and trademarks law (Ley sobre el Control y Registro de la Transferencia de Tecnologia y el Uso y Explotacion de Patentes y Marcas) superseded the 1976 industrial properties law. Regulations governing implementation of the revised law were adopted in November 1982. Modifications were added in January 1987.

The de la Madrid government has consolidated the Office of Technology Transfer and the Office of Patents and Trademarks into one unit—the Department of Technology Development, Patents and Trademarks. It has also shifted control of this unit from the FIC (3.00) to Secofi's Subsecretariat of Foreign Investment Regulation and Transfer of Technology.

Mexico's development goals have led the authorities to look for foreign licensors with needed technology and put them in touch with potential local licensees. Licensing arrangements are still common for international companies in Mexico, both in

Patents and Trademarks in Mexico

Conventions. Paris Convention 1883–1967, World Intellectual Property Organization (WIPO).

Basic laws. Law of Inventions and Trademarks, 1976, and modifications to this law dated Jan. 16, 1987; also, Law on the Control and Registration of the Transfer of Technology and the Use and Exploitation of Patents and Trademarks 1982 (regulatory guidelines published in the Official Gazette of Nov. 25, 1982).

PATENTS

Type and duration. Patents of invention or improvement, 14 years; no renewal.

Unpatentable. Patents are not available for inventions involving food processing, pharmaceuticals, agriculture, pesticides, herbicides, fertilizers, pollution control or nuclear energy, although processes for obtaining such products are now patentable. Also unpatentable are inventions whose publication or exploitation would be contrary to law, public order, health, public safety, good habits or morals. Chemical products may not be patented; however, industrial methods for obtaining them and industrial applications may be patented.

Application and examination procedure. File with legalized power of attorney at the Direccion General de Tecnologia, Invenciones y Marcas, Salvador Alvarado 56, Co. Escandon, Mexico, DF. Examination is under the jurisdiction of the Secretariat of Commerce and Industrial Development. Publication in the Gazette of Industrial Property is required, and application is subject to prior scrutiny for two months to check whether other Mexican patent or pending application exists. It is advisable to make an application for special examination (nullifying any claim against novelty after five years). Mexico now accepts the finding of international examining offices when reviewing applications for patents on products already patented abroad.

Fees. Application: P44,000; P22,000 each for examination of novelty or use; P11,000 for reconsideration of negative response; P12,500 for review application or completion of missing information; P66,000 for the expedition of titles and for annual fees in the first three years; P20,000 annual fee beginning with the fourth year, P29,500 as of the eighth year; P16,500 for transfer, modification of contract or change of name.

Compulsory licensing is possible when patents are not worked sufficiently to fulfill domestic market needs or to exploit potential markets fully, when they are not worked within three years, or for reasons of public health, national defense or public interest (see text for further details). Patents can also be expropriated if such action is deemed to be in the public interest or for reasons of health, national security, etc.

Inventor's Certificate

Type and duration. Provides payments of royalties on certain unpatentable products; 14 years; nonrenewable.

Fees. Application P5,500, plus P5,500 for each license, modification of contract, examination of novelty and transfer. P5,100 for document replacement or for complementing missing information. P5,500 for transferring patent application to inventor's certificate information.

TRADEMARKS

Duration. Good for five years and renewable for like periods as long as marks are commercially used. Marks not put to use within three years are voided.

Legal effect. Right is established through use. Registration establishes an exclusive right to use by the registrant, but there are prior rights granted to earlier nonregistered users of trademarks.

Not registrable. Political symbols, technical or common terms normally used to describe a product; geographic names; surnames used without permission; marks contrary to morals or deceitful; those lacking novelty; words for items to be made only in Mexico and Latin America.

Linked trademarks are no longer required and were not enforced in the past.

Procedure. Applications are made to the Industrial Property Office and are published in the *Gazette of Industrial Property* and the *Official Gazette*.

Fees. Application fee for a trademark to be applied to one product, P11,600; for two to 10 products, P22,000; to more than 10 products, P44,000; recognition of prior rights, P16,000; verification of use, P22,000; renewal, P22,000 or P44,000, depending on the class of the mark; P487,000 for registration of an expired trademark for one to nine products, if applied for within one year of expiration; P11,000 for transfer, modification of contract or change of name.

INDUSTRIAL DESIGNS AND MODELS

Application procedure is the same as for patents; duration is seven years, nonrenewable.

Fees. Application: P11,000, plus P11,000 for each right granted; P22,000 for the initial expedition of title, including the first three years' annual fees; annual fee, P11,000 each for the fourth and fifth years; P5,300 for transfer, modification of contract or change of name; P5,500 for examination of novelty; P4,900 for a review of the application.

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conjunction with direct investment and independent of it, although Mexican officials usually prefer that a technology supplier share the risks of a new venture by taking a capital stake.

6.02 Patent and trademark protection. In early 1987, Mexico made some modifications in its 1976 patent legislation. But the changes were not enough to prevent the country from losing GSP benefits in early 1987 because of a US Trade Representative Office finding that Mexico was not providing adequate protection for intellectual property.

Under the revised law, the length of patents is increased from 10 to 14 years. Industrial drawings and models will be protected for seven years instead of the previous five. Mexico only offered the pharmaceuticals industry the promise of product patents in 10 years. Process patents did become available in a number of areas the old 1976 law left unprotected, but the process patents are generally considered inadequate protection. Now available are process patents on pharmaceuticals and chemicals, agrochemicals and manufacturing alloys as well as patents on nuclear energy processes (which do not compromise national security) and processes for antipollution equipment.

The revisions also did away with mandatory trademark linkage requirements and beefed up penalties for trademark piracy. Pirates can now get two to six years in prison. New enforcement procedures allow goods or services to be seized at the time an initial complaint is filed with the Attorney General's Office, rather than after a lengthy legal process. In early 1987, two longstanding trademark infringement cases were settled—one involved a dispute over the Nike tennis shoe, and the other the use of the Christian Dior trademark.

In a red-tape cutting measure, the Commerce Secretariat will now accept the findings of international novelty examinations when firms seek Mexican protection on products already patented abroad. This should speed up the normal three- to four-year approval process.

Companies operating in sectors without product patents may, however, apply for inventors' certificates (*certificados de invencion*), which provide for payments of royalties but also make the technology available to all who want it. The authorities fix royalty levels if private parties fail to agree. Majority foreign-owned pharmaceuticals firms will receive authorization to manufacture previously imported active ingredients only if no Mexican firm applies for a license. In the case of chemicals, only new industrial methods for obtaining them and their new industrial applications may be patented.

A clause in the law allows expropriation of patents for the public good and obligatory licensing of patents. A patent holder can lose exclusivity for several reasons, including the following: (1) failure to put a patented process to industrial use within three years of approval; (2) failure to use the process for a period of six months; (3) failure to exploit the domestic market fully; and (4) failure to exploit potential export markets.

If a third party applies for an obligatory license under any of the above conditions, the patent holder has two months to propose a program to change the offending condition. If the holder fails to devise a suitable program, a compulsory licensee is designated. The government may fix the royalties if the two parties cannot reach an agreement. The patent holder is required to provide necessary backup to help the designated licensee. If no compulsory licensee steps forward within a year after the patent holder loses exclusivity, the patent becomes void. Up to now, however, the clause has never been applied.

Patents and inventors' certificates are valid for 10 years from the date of granting. Obtaining final approval often takes two to three years. The cost of securing a patent or certificate ranges from P100,000 to P220,000 if the application is handled through a well-established law firm, a procedure that is highly recommended.

Authorities require a number of trade-offs, mainly focusing on local technology development. Firms will have to channel a percentage of sales to human resources development as well. They must provide scholarships that can range from financing employees' technical training in Mexico to doctorate degrees abroad. In some cases, renegotiated contracts also stipulate provisions to give direct technical assistance to local suppliers, and may even include a development program for suppliers so that these will eventually start to sell abroad. MNCs are asked to support these export efforts through their international marketing network. Companies must also offset their royalty payments with exports, though not necessarily of their own products.

A trademark must be used within three years of registration or be voided. However, for one year following these three years, the trademark cannot be adopted by unrelated applicants. During this period, the firm that originally registered the mark but never used it may reapply for registration.

Trademark certificates are good for five years and can be renewed indefinitely with proof of the mark's actual use. Registering a mark currently costs P61,500 plus about $500 in lawyer's fees. The process takes six months to a year; protection begins on the first application.

In 1986, Mexico granted 987 patents out of 3,700 requested. Of 306 inventor's certificates applied for, 235 were approved.

While Mexico has begun to take a harder line toward pirates in recent years, legal red tape and corruption in the legal system make the control of pirate operations extremely difficult. A firm can spend years in court shutting down one pirate operator only to have another one spring up after the shutdown. Pirating of clothing trademarks has become particularly prominent in recent years. Where applicable, lawyers advise pursuing pirates under Mexico's copyright laws, which are tough and enforced more efficiently by the Secretariat of Public Education. By using this approach, Televisa had little problem shutting down videocassette operators who were pirating Mexican as well as international films. The laws have also proven effective in dealing with software piracy. Mexico is a signatory to the Universal Bern Convention on Copyrights.

6.03 Legal and administrative limitations on licensing. A new law regulating the transfer of technology took effect in 1982. All technology contracts are now subject to approval by the Department of Technology, Development, Patents and Trademarks, and they must be registered with the National Registry of Technology Transfer. Such contracts cover the use of patents and trademarks or the supply of plans, diagrams, models, instructions, formulas, assignments, engineering details for installations, managerial and technical assistance, consulting and evaluation services, and computer programs. Agreements involving in-bond plants (*maquiladoras*—13.05), which were previously exempt, must also be registered.

New technology-transfer contracts must be presented within 60 days of execution, and the authorities have 90 days to decide whether the contract qualifies for registration. If the 90-day period elapses without a response, the contract is automatically registered. However, the agency may cancel the registration if it finds that the contract has been modified in practice.

Nonregistered contracts have no legal validity, and companies cannot establish or expand manufacturing operations or receive incentives unless related technology-transfer contracts are registered. Amendment agreements or side letters cannot be enforced though Mexican courts.

When a firm submits a licensing contract for consideration, it must pay P42,000 plus P28,000 for each patent or trademark mentioned in the agreement; actual registration costs another P28,000. Modification of the contract once it has been registered requires additional fees. The registry also charges a P28,000 annual renewal fee for continuing inspection.

Practices forbidden by the 1982 law include obliging a licensee to submit disputes to foreign courts (although provisions for international arbitration are permissible); restricting a licensee's exports so as to damage Mexican interests; limiting a licensee's R&D efforts; limiting production volumes or setting sales prices; obliging a licensee to buy equipment, tools, parts or raw materials only from a certain supplier; limiting a licensee's sales freedom; or obliging a licensee to sign exclusive sales or representation contracts with the licensor.

Also prohibited are contracts that involve the transfer of technology freely available in Mexico; establish excessively long terms (10 years is generally considered a maximum); set a price that is out of proportion to the technology sold—i.e. one higher than that charged for comparable technology easily available elsewhere or one that imposes an excessive burden on the Mexican economy or the buyer; permit the licensor to interfere with the management of the licensee; or disallow the use of complementary technology.

Recognizing common industrial practices, however, the authorities slightly modified the previous prohibition against grant-back clauses. Mexican firms are now permitted to share with suppliers new developments and refinements they make in technology acquired abroad if there is a reciprocal arrangement or other benefits to doing so. The ruling against obligatory sales or representation contracts with the supplier has also been softened. Authorities will allow such contracts for exports if the Mexican purchaser accepts the deal and can prove that the foreign supplier has either the expertise or the image to do a better marketing job than the Mexican firm.

6.04 Royalty and fee patterns. The Department of Technology, Development, Patents and Trademarks does not establish firm guidelines on acceptable royalty rates. Until recently, 3% of net sales was generally considered the maximum royalty on domestic sales; now officials will allow higher rates, in some cases they say as high as 10%, if they feel that the technology contributes to Mexico's specific development goals. Lawyers say that in practice the rate appears to top out at 7% and the higher rate is usually on export sales. Higher domestic sales rates of 4–5% have also been obtained recently in cases where the company implements technology assimilation and supplier development programs. Rates above 1–2% are generally only given to well-known brand names.

Authorities are looking for technology packaged in a way that allows the licensee to effectively absorb and/or modify it. There is a new emphasis on models and plans. Rulings also give preference to know-how that optimizes Mexico's natural resources and does not have a harmful effect on the environment. Rather than receiving a final contract, officials want to be involved in drawing up the agreement, and many companies make it a practice to consult authorities before handing in their proposals.

In line with their quest to create a local technology base, officials are now asking companies for substantial contributions to domestic research and development. Firms must channel a fixed dollar amount, rather than a percentage of sales, into local R&D over the 10-year period, and they must present specific research projects within or outside of the company. They are also asked to give technical assistance to local suppliers. In addition, technology receivers must offset royalty payments with exports, and officials stress that these exports must consist of products made with the purchased technology. If authorities consider that the product has export potential, they may require that export revenues exceed royalty outlays and increase over the period of the contract duration.

The government permits technical-assistance fees to be paid to overseas residents only if the services are (1) rendered by those possessing the technical capacity to do so; (2) performed directly, and not through third parties; and (3) not otherwise available. The primary purpose of the rules is to ensure that technical services are indeed rendered and not just used as a means of avoiding taxes.

7.00 REMITTABILITY OF FUNDS

7.01 Exchange controls. Since December 1982, a two-tiered exchange rate has been in force. The controlled rate applies to export revenues, all imports, private and public sector foreign debt, royalty payments, in-bond plant expenses and the government's overseas diplomatic expenses. Firms can also purchase controlled dollars for import credits incurred after Dec. 20, 1982, or deduct these payments from their export revenues. In 1986, Banco de Mexico liberalized the rules covering access to controlled-rate dollars for advance payments on imports. Advance controlled-rate dollars are available for the entire cost of the import up to $10,000. Beyond that amount, controlled-rate dollars are available for advance payments covering up to half the import costs. An exception is made for capital goods imports; controlled dollars for advance payments are limited to 20% of the value. All other transactions fall under the free rate.

The controlled exchange rate transactions fall under one of two categories: The *tipo de cambio de equilibrio* is a floating controlled rate set each day at a Banco de Mexico meeting. Companies have the option to contract for the purchase or sale of foreign currency either at this official daily rate or at what is known as the *tipo de cambio ventanilla*. Under the latter system, each bank posts a rate at which it will buy or sell dollars on that particular day. Essentially, banks cover themselves for any daily jumps in the *equilibrio* rate by keeping a small margin between the buy and sell rates. Companies that need foreign currency in a hurry use the *ventanilla*; the *equilibrio* route takes up to four working days.

In January 1987, the government launched a futures market for the controlled-rate peso, which is managed by Mexican banks and authorized exchange houses. The forward market has drawn little interest from MNCs, however, because of the high premiums charged. The scheme also does not guarantee access to controlled dollars, only the peso equivalent. Because of this, the market does not qualify as a true hedge under many firms' internal financial controls. The relative stability of the peso and easy access to free-rate dollars at nearly the same rate as controlled dollars has also discouraged use of the market during the first four months of its existence. But an upswing in peso volatility could lead to greater use.

Another forward hedge exists in the Pagare de la Tresoria de la Federacion (pagafe). The pagafe was launched in July 1985 and has also received a cool reception. The pagafe is denominated in dollars but bought and sold in pesos at the controlled rate. There is no secondary market for sale of the pagafes. The 180-day term of pagafe issues has made them difficult for exporters to use effectively. Yet, while in 1986 pagafes had a modest average annual yield of 4%, pagafe yields on an annualized basis have risen to over 12% in 1987.

During the first three months of 1987, the *equilibrio* rate—which is supposed to be set according to supply and demand—slipped 20% during the first quarter against inflation of 21.9%. During the same period, the free rate devalued 22%. The strategy of the central bank appears to be to keep devaluation roughly even with inflation but not to have devaluation lead inflation as it did in 1986, when the controlled rate devalued 148% versus inflation of 105.7%

Since July 1985, the free peso has been on a free float, with banks and exchange houses setting daily rates. The Central Banks does intervene effectively at times to control wide fluctuations in this market. Except for a brief period in June 1986 when the free peso was allowed to fall rapidly to discourage capital flight (which was a reaction to balance-of-payments pressures), the peso showed surprising stability in 1986, ending the year at P923:$1 for the controlled rate and P914.5:$1 for the free rate. The controlled and free rates became equal briefly in December 1986. In 1987, the differential has been about 0.04% through the first four months.

Officials exercise strict control on the use of foreign exchange. Exporters must promise to sell their export proceeds to local banks within 90 days. From these revenues they may deduct import costs, import- and export-related expenses and payment of bank and supplier credit not enrolled in any of the government's special programs (see 7.06 for payment options for principal and interest on foreign loans). Companies must keep a certified register of all their foreign currency transactions—including bank and supplier debts, foreign exchange credits, accounts receivable and payables and cash operations. Incorrect invoicing (e.g. underinvoicing of exports and overinvoicing of imports) and other violations of foreign exchange regulations are heavily penalized, and in cases of recurrence, violators may be kept from exporting or purchasing foreign currency for import purposes.

7.02 Transfer of profits and dividends. Profits and dividends are freely remittable, provided a company is registered with the National Registry of Foreign Investment and meets legal reserve requirements and tax obligations (8.09). By law, firms are required to distribute 10% of their pretax profits to employees and allocate 5% of net profits to the legal reserve until 20% of stated capital has been set aside.

7.03 Transfer of interest is subject to Banco de Mexico regulation (see 7.06 for payment options for principal and interest on foreign loans).

7.04 Transfer of royalties and fees can be made at the controlled rate provided the contract under which the fees are to be paid has been duly registered with the National Registry of Technology Transfer (6.03). Licensees, however, are allowed to calculate the dollar equivalent of the peso amount due at the free rate and purchase the dollars at the controlled rate, thereby reducing their effective cost without affecting flows to the licensor.

7.05 Repatriation of capital. Since the partial relaxation of exchange controls in December 1982, capital repatriation has not been explicitly prohibited; however, such transfers are subject to the availability of foreign exchange, and the authorities could impose restrictions on capital movements to stem capital flight. In 1986, foreign-owned firms remitted $296.1 million, according to Mexico's capital account.

7.06 Repayment of principal. The Mexican government has established several programs to aid the private sector with the payment of its foreign obligations. One of the debt-repayment/exchange-coverage schemes is the *Fideicomiso para la Cobertura de Riesgos Cambiaros* (Ficorca) program, which was in force from April 6 to Oct. 25, 1983. The program offered several options for covering future payment of principal—or principal plus interest—on foreign debt incurred before Dec. 20, 1982. Creditors were able to make peso deposits for the equivalent dollar debt at preferential exchange rates that were tied to the term of the renegotiated debt. A minimum term of six years with three years' grace was required; peso credits at the average cost of three six-month peso deposits were available.

Almost $12 billion was initially covered through Ficorca, representing two thirds of the private sector's $18 billion foreign debt. Of the 1,200 companies that participated in Ficorca, 94 chose the option that covered principal and interest and included a peso credit. Ficorca made a stunning P1.6 trillion in such credits available—almost equal to the Mexican banking system's total credit portfolio at the time. Both the government and the banks knew the payout schedule was unworkable. In early 1987, Mexico and the foreign banks renegotiated the remaining $10.3 billion in Ficorca, stretching payments out over 20 years with seven years' grace—the same period agreed to in the renegotiation of the public debt.

Guidelines for firms wishing to renegotiate individual Ficorca contracts were published in early 1987 (Schedule G). The renegotiation option is available only to firms enrolled in the original Ficorca program. Approval of foreign creditor banks is normaly also required. Firms electing to renegotiate can choose one of two options for refinancing their peso credits: (1) Firms can refinance out to eight years, with four years' grace. The interest rate would be the average of three- and six-month CDs. The peso value of these credits, however, would be recalculated at the controlled rate effective on the day of the restructuring. (2) Firms can refinance out to 12 years with six years' grace, maintaining their present Ficorca contract exchange rate, but at the higher interest rate of 110% of CPP.

The new tax plan limits the deductability of Ficorca exchange losses and interest payments. A number of companies have taken a hard look at the option of doing debt swaps to prepay Ficorca. In some cases, the debt can be paid off at $0.50 on the dollar when the debt swap premium and preferential Ficorca exchange rate are taken into account. Some firms have also sold their Ficorca contracts to other companies, although the practice has been rare since 1986.

Companies were also able to pay off principal and interest of past-due supplier debt incurred before Dec. 20, 1982, through various programs. For instance, firms could cover these debts by depositing pesos at the controlled rate into dollar-denominated accounts; these dollar deposits then became an asset of the creditor. Banco de Mexico covered a total of $800 million through such schemes. The average amortization period of a long-term credit must be at least 12 months, and 20% advance payment is allowed. Importers can purchase controlled dollars for interest payments on these credits up to the maximum yield of three-month deposits in the corresponding foreign currency on the date interest payments are due; the remainder must be covered with free-rate dollars.

Several payment mechanisms are available for supplier credits that are secured by foreign government agencies in the US, Europe and Japan. Their governments make credits available through Mexico's foreign trade bank (Bancomext) and Nacional Financiera (Nafinsa), which then pay the outstanding debt to the foreign creditor.

Mexican debtors with payments that fell past due before

Dec. 31, 1983, can make peso deposits at the controlled rate for the amount of debt and interest in dollar-denominated accounts in favor of the foreign creditor. Creditors may withdraw from these accounts and receive pesos plus the equivalent of LIBOR at the controlled rate in force on the day of withdrawal once payment schemes for their respective credits are announced; Mexican debtors are, as a result, hedged against exchange risk. Foreign government-secured import credits that are past due or that fell due after Jan. 1, 1984, can be covered directly by debtors. These payments can be made with controlled dollars.

New foreign currency borrowings must be converted at the controlled rate and be registered at the Secretariat of the Treasury (Hacienda). Coverage for the foreign exchange risk of certain new long-term credits is available at moderate rates through Ficorca. Some firms have successfully bought an old Ficorca contract with a lower exchange rate from another company. Usually the two companies split the gain from the exchange rate savings on the new debt.

7.07 Guarantees against inconvertibility. None.

8.00 CORPORATE TAXES

8.01 General. Mexico has introduced sweeping changes to its income tax law. The primary objective is to speed up tax collection and stop the decline in the tax base caused by inflation—all with the aim of boosting government tax revenue, which had been falling in recent years as a percentage of GDP. A secondary objective is to promote productive investment and discourage excessive indebtedness.

The first moves came in April 1986, when a special session of Congress accelerated tax payments, increased companies' mandatory contributions to social security and partially eroded some existing incentives. Then, in November 1986, Congress passed a new income tax law, which will be phased in over the next five years. During the transitional period, firms will pay a percentage of their income tax as figured under the old income tax system known as title VII and a percentage under the new system known as title II. In 1987, firms will pay 80% of their taxes under the old system and the remaining 20% under the new system. The effects should be mild this year but will become of more concern in 1988, as the percentage becomes 60% and 40%, under the old and the new tax systems, respectively. In 1989, firms will pay 40% under the old system and 60% under the new. In 1990, it will be 20%, old system, and 80%, new. In 1991, the new system will be fully in effect.

The tax rate will continue to be 42% under the old system but drops to 35% under the new tax plan. During the transitional period, firms will apply the two rates for each system and take the appropriate percentages.

The chief difference between the two systems is the introduction of inflationary considerations into the calculation of net taxable income in the new system. The negative effects are most prominent on interest deductions (exchange losses are considered as interest, as are net gains from sale of financial instruments such as petrobonds.). Favorable effects can be generated by the inflationary adjustment of interest income.

The goal of the system is to recognize the real reduction in debt that occurs as a result of inflation, and the corollary increase in the real return on assets in an inflationary environment. Under the plan, if the reduction in debt that occurs as a result of inflation is larger than the amount of interest paid out, a firm will be taxed on the difference—which is termed an inflationary profit. Likewise, if the return on assets is less than the inflationary increase in value of the assets, companies generate a deductible inflationary loss.

The effect is to greatly expand the tax base of heavily indebted firms. Firms with more debt than assets will pay more under the new system. Those firms with little or no debt will benefit from the reduction in rates under the new tax system. As firms will still have 80% of their income taxed under the old system in 1987, tax consultants note that there will still be benefits to generating high levels of interest and exchange loss deductions. Major changes in tax strategies will have to be made as the new system takes a bigger bite in 1988 and 1989, however.

The new tax plan also freezes inventories and allows immediate deduction of all purchases. Firms will get no tax benefit from inventories maintained after the four-year tax period. Inventories not deducted during that period will not be deductible until the firm is liquidated. While in 1987 firms will still benefit from inventory deductions, inventories should be reduced to the minimum in following years.

The new law also introduces a choice in depreciation allowances. Firms may take either a straight-line depreciation or a one-time deduction of the present value of the asset.

During the transition period loss carryback is suspended but carryforward is expanded to five years. Losses are revalued based on a Banco de Mexico index when taken against the new system. However, the procedure for revaluation effectively limits this to four years. Carryback will be reinstated in 1991 when the new system is fully operational.

Once net taxable income is calculated under the new and old systems, tax calculation is the same. Mandatory profitsharing and dividend treatment remain unchanged. The Mexican Congress repealed a law that would have switched to a creditable tax system in treatment of dividends in 1987.

Since December 1985, retailers have been required to incorporate the value-added tax (VAT) into shelf prices—rather than levy the VAT separately at the time of purchase. In 1987, a 10% surcharge on high income wage earners for earthquake reconstruction was repealed.

8.02 Corporate income tax rates. Over the next four years, companies will pay taxes at two rates under the two systems. A 42% rate will be applied under the old system, and 35% applied under the new system. Companies earning under P250 million qualify as medium-capacity firms and pay taxes on a simplified system with set rates for depreciation, and interest deductions as well as interest income. A new firm starting up that does not expect to make P250 million its first year can pay taxes based on this system as well.

Individuals carrying out business activities and earning up to P16 million are know as small taxpayers; they pay income taxes at graduated rates ranging from 5% to 42% and are required to follow simple bookkeeping procedures. Mexico has no local or state corporate income taxes.

Corporate Taxation in Mexico

Below is a highly simplified example of how to calculate the tax burden on a wholly foreign-owned company operating in Mexico with P100 million in taxable income and paying a cash dividend of P30 million over the tax year's earnings. P30 million in dividends was paid the previous year over that year's profits. Note that inflationary gains or losses related to interest income or payments are not included in this simplified model. Also, the corporate tax rate is based on a mix of 80% under the old system and 20% under the new.

(1) Taxable income	P100,000,000
(2) Net taxable income	70,000,000
(3) Corporate income tax	25,578,000
(4) Mandatory profitsharing—10% of (2)	7,000,000
(5) Dividend withholding tax—55% of P30,000,000 (dividends paid this year)	16,500,000
(6) Total tax payable	49,078,000
(7) Effective tax burden	49.1%

Income generated by branches or agencies of foreign firms is subject to the same federal tax, plus a 55% withholding tax (whether or not the income is remitted) on the aftertax balance.

The 42% corporate tax rate under the old system is reduced to 40% for firms engaged solely in agriculture, livestock raising, forestry or fishing, to 25% for firms that also process their produce and to 25% if these companies obtain 50% of their gross income from industrial or trade activities.

8.03 Taxable income defined. Taxable income for local companies and branches is defined as gross income less costs and expenses related to producing that income, with exceptions. Items that are not deductible are income tax payments, profitsharing (12.05) or other payments conditional on profits, provisions for employee liability or indemnity reserves, premiums over par on stock redemptions, and income from technology exports. Promotional and travel costs may be subtracted, provided the tax authorities believe they are legitimate business expenses.

Foreign exchange losses are fully deductible under the old system on an accruel basis. Under the new system, exchange losses are considered interest. The amount of interest—if any—hat exceeds the inflationary reduction of the debt is deductible.

Calculation of exchange losses remains the same. To calculate the loss, a company uses the difference between the exchange rate in effect when the foreign currency liability was incurred and the rate at which payments are due. In 1983, officials ruled that if companies renegotiated their foreign credits on longer terms, they could take the full deduction for exchange losses at the controlled rate in force on Dec. 31, 1983 (P96:$1), even if they were unable to make the payments. Exchange losses can still be taken when a payment is due, even though it is not actually made; the debtor no longer has to extend the terms of the obligation to take the exchange loss. Additional loss suffered when payment is made may also be deducted; it is figured at the difference between the exchange rate—for which the credit was eligible, not necessarily the one at which it was paid—at the rate and the date at which payment is made. Exchange losses or gains on cash and other liquid-instrument operations included in a foreign exchange register are calculated on a LIFO basis.

There are three alternatives for tax deduction of exchange loss on debt enrolled in Ficorca. They are as follows:

- The deduction can be taken in one sum during the year the loss is suffered. An earlier provision allowing losses to be spread in equal shares over four years—beginning when payment would have been due under the original loan terms—or when payment is actually made under the program has been repealed effective Jan. 1, 1987. Under the new system, exchange losses are revalued by a CPI-based factor, then reduced by the amount of the inflationary component of the debt.
- Under the old system, Ficorca interest deductions can be taken spread over the length of the contract or as they come due. Firms that previously elected to spread interest deductions over the contract period have the option to change in 1987 to the "as interest comes due" option. Interest deductions not taken on interest paid prior to 1987 would stay on the old system.
- Under the new system, Ficorca interest must be deducted or declared as it accrues. Interest paid but not deducted prior to Dec. 31, 1986, must be revalued by the Banco de Mexico factor and reduced by the inflationary component of the debt. The Ficorca interest deductions are treated the same way.

Foreign exchange gains accrued are taxable in the fiscal year in which the claim or the debt comes due according to the original terms of the debt. Any additional exchange gains between the due date and the payment date are taxable in the fiscal year payment is made. Between 1987 and 1990, exchange gains incurred on offshore deposits will be taxable only on the real component in both the new and the old tax systems. Accumulated interest and exchange gains are reduced by the inflationary component of the deposits that generated them.

Amendments to the tax law, effective Jan. 1, 1983, stipulate that Mexican companies that pay dividends may deduct such distributions from taxable income unless the dividends are paid in the form of shares or unless the recipient reinvests them in the payor through a share-capital increase within 30 days. (In the latter case, the deduction may be taken in the year the share capital is decreased or the company is liquidated.)

Also, companies that pay dividends must withhold 55% of the gross amount distributed to resident individuals and nonprofit organizations and all overseas recipients; such withholding is not required for dividends paid to another resident firm (see also 8.09 and 9.00). Dividends are tax deductible only if paid out of the prior year's earnings.

As of Jan. 1, 1985, firms could no longer deduct dividends generated by gains resulting from a revaluation of assets or any B-10 inflation effects. Companies that register losses while paying out dividends must adjust their final results by the amount of the payout. A planned shift to a creditable tax system in 1987, which would have ended deductibility of dividends, did not occur, and the law authorizing it was repealed (see box on p. 18).

Dividends received by residents in cash or in kind (except for those reinvested) must be included in taxable income, but individuals are allowed to deduct the dividends paid out. A recipient firm can offset this additional tax cost if it pays dividends to its shareholders out of retained earnings not subject to deductibility restrictions—e.g. dividends paid out of earnings generated before end-1964 may not be deducted.

Operating losses incurred in 1982 and 1983 may be carried

Mexico's New Tax System

Over the next four years, companies will calculate their taxes twice—once under the old system and once under the new system, paying a percentage of the tax due under each system. In 1987, the mix is 80% old and 20% new. A 42% rate is in effect under the old system and a 35% rate under the new. The chief difference between the two systems is the introduction of inflationary considerations into the calculation of net taxable income in the new system. The effects are most prominent on interest deductions (exchange losses are considered as interest, as are net gains from sale of financial instruments such as petrobonds). The goal of the system is to recognize the real reduction in debt that occurs as a result of inflation. At the same time, only real interest earnings are taxed. For example, if a firm had P500 million in exchange losses and paid P800 million in interest, while having a total debt of P42 billion and assets of P10 billion, and having earnings during the period of P5 billion sales and P900 million in interest, the results for the two systems would be as follows.

Old System

Gross revenue	P5,000,000,000
Plus interest income	P900,000,000
Minus interest paid	P800,000,000
Minus exchange losses	P500,000,000
Equals	P4,600,000,000

New System

The P800 million in interest plus P500 million in exchanges losses equals P1.3 billion in total interest under the new system. This amount is then reduced by the inflationary reduction of the total debt (this is done by multiplying the adjusment factor, which is the difference between the current month's CPI index and the CPI index at the beginning of the period minus one. For the sake of this example, assume the difference minus one is 0.06. We multiply total debt, P42 billion, by 0.06 and obtain P2.52 billion. This is the inflationary component of the debt. We then take P1.3 billion minus P2.52 billion. Since the inflationary component is larger than the interest paid we have a taxable inflationary gain of P1.22 billion. Debt is defined as all debt including that stemming from client advance payments, financial leasing and funds provided for future capital increases. Excluded are tax debts and profitsharing. Also exempt from the inflation adjustment are company reserves for retirement and pensions, as well as reserves that do not correspond to a definite debt and are not payments that are deductible. Deferred credits are also excluded.

Interest received as income would be handled similary if we had P900 million in interest income. It would then be reduced by the inflationary component of the assets that generated the interest income. Considered as credits are deposits with Mexican banks, deposits with brokerage houses or offshore deposits (offshore interest is calculated at the exchange rate in effect at the first of each month) and accounts receivable payable in 30 days or more. The total amount of credit outstanding is then multiplied by the inflationary factor (0.06 × P10 billion equals P600 million). This gives us a taxable interest income of P300 million. The outcome under the new sytem would be this:

Gross revenue	5,000,000,000
Plus inflationary gain on debt	P1,220,000,000
Plus interest income	P300,000,000
Equals taxable income	P6,520,000,000

Because the hypothetical firm in question has more debt than assets, the taxable income jumps substantionally. On the other hand, if a firm has less debt than assets the effects start to become favorable.

In terms of cost of sales, the new tax plan freezes inventories and allows immediate deduction of all purchases. Firms will get no tax benefit from inventories maintained after the four-year phase-in period. Inventories not deducted during that period will not be deductible until the firm is liquidated or changes business activities. While in 1987 firms will still benefit from inventory deductions, inventories should be reduced to the minimum in following years.

The new tax law also introduces a choice in depreciation allowances. Firms may take either a straight-line depreciation or a one-time deduction of the present value of the asset.

During the transition period, loss carryback is suspended but carryforward is expanded to five years. Losses are revalued based on a Banco de Mexico index when taken against the new system. The procedure for revaluation, however, effectively limits this to four years. Carryback will be reinstated in 1991, when the new system will be fully operational.

Once net taxable income is calculated under the new and old system, tax calculation is the same. Mandatory profitsharing and dividend treatment remain unchanged. The Mexican Congress repealed a law that would have switched treatment of dividends to a creditable tax system in 1987.

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back for one year and may be carried forward six years. Losses incurred before 1982 can only be carried forward four years. Starting in 1987 and through 1990, loss carryback is suspended. Losses can be carried forward for five years. In 1991, when the new system is fully functioning, carryback will be reinstated. Losses taken against the new system are revalued by a CPI-based index.

Carryforward is not permitted for losses incurred to drive out competitors, to write off uncollected accounts or to set up nonspecified employee pension funds. Firms may deduct their losses in one line of business from profits in another.

A temporary regulation of the tax law states that income received through monetization of tax-incentive certificates (Ceprofis—10.04) is not taxable if the income is received in 1983, 1984, 1985 or 1986. The Mexican government also did not follow through with plans to make the value of Ceprofis taxable income in 1987. Ceprofis remain tax exempt, but must be included as income in calculating mandatory profitsharing.

Related majority Mexican-owned companies may pool their profits and losses for tax purposes. To resolve some of the uncertainties regarding fiscal consolidation, the tax law contains the following provisions:

- Once a group opts to file a consolidated return, it must continue to do so in subsequent years unless it obtains the tax authorities' permission to stop.
- The subsidiaries within the group are relieved of some standard bookkeeping requirements, since the information will appear in the parent company's books.
- The adjusted tax loss of a separate company cannot be applied against the consolidated net taxable income of the group if the separate company was not a member of the consolidated group in the prior fiscal year.
- Loss carryforward of the group, as well as of the parent, that originated before the time of consolidation may no longer be deducted from the group's consolidated taxable income.

Any foreign-sourced income received by resident companies

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is subject to Mexican tax, but companies may credit income taxes paid abroad, within certain limitations, against the amount of Mexican tax due. Technically, companies not domiciled in Mexico are taxed only on their Mexican-sourced income, but no clear-cut rule establishes sources of income liable to Mexican tax.

In general, income is deemed to derive from "sources in Mexico" when the assets or activities are in Mexico or when the sales or contracts are put through in Mexico, regardless of where title passes. Firms or individuals are considered to be domiciled in Mexico and therefore liable to Mexican tax if represented by an agent who can enter into contracts on their behalf. The source of income from services rendered in Mexico and income from Mexican branches of foreign corporations is always deemed to be Mexican. The same holds true for interest payments, royalties, etc., when one of the parties to the contract resides in Mexico.

In view of Mexico's high inflation, the Mexican Accounting Institute has introduced standardized procedures for asset revaluation for all financial statements ending Dec. 31, 1984, and later. These procedures, known as B-10, are obligatory for all companies registered with the Mexican stock exchange. Many US-affiliated firms do not use B-10 since their results will be adjusted at headquarters with the application of FAS No. 52. The Mexican Accounting Institute does not levy any sanctions on nonpublicly traded companies that do not use B-10; it is, however, required to mention in a footnote that results were calculated according to historic costs.

These regulations give firms the option of choosing between the constant-peso method, which adjusts for price changes by applying a factor derived from the central bank's CPI, and the replacement cost method, a variation of the current cost-accounting technique. Firms can use both methods, except if they consolidate financial statements. Inventory, cost of sales, fixed and net assets, results of nonmonetary assets and the cost-of-financing concept must now include interest payments and exchange rate fluctuations. These results, which were formerly mentioned in a footnote, must now appear separately on the income statement, except when the result of the monetary position is positive, in which case it can be brought directly to net assets.

8.04 Depreciation is calculated on a straight-line basis under the old tax system. Firms have a choice between straight-line depreciation and a one-time present value deduction under the new. The annual rates for machinery and equipment vary by industry. Examples are metal production, tobacco and natural coal derivatives (7%), pulp and paper manufacturing (8%), manufacturing of motor vehicles and parts, metal products, machinery, professional and scientific instruments, beverages and food processing (9%), chemical, petrochemical and pharmaceutical products as well as rubber and plastic products (11%), textiles, apparel (17%), airplane construction (17%), agriculture, stock-raising and fishery (37%).

Special rates apply to some items, such as dies and molds, pollution-control equipment and equipment used to develop new products and local technology (all 40%), aircraft used for agricultural fumigation (37%), other aircraft (25%), buses (16%), electronic computing equipment (37%), mechanized equipment for computer systems (17%) and rolling stock (6%).

All industries are allowed a 5% rate for buildings and construction, 5% for intangibles (excluding goodwill) and deferred charges, 10% for office equipment and 20% for certain trucks. Intangible assets may be depreciated at a 10% annual rate.

Accelerated depreciation is authorized only for certain assets. A special permit must be obtained from the Secretariat of the Treasury. The authorities decide on a case-by-case basis when accelerated depreciation may be used. Firms that entered into accelerated depreciation allowance agreements between 1984 and 1986 may continue to use them and make deductions against both the new and old tax bases.

Otherwise, firms have recourse only to the present value deduction under the new system. No present value deduction is allowed, however, for office equipment or equipment or goods acquired through financial leasing.

New present value depreciation rates are the following: construction, 51%; automobiles, 81%; computer equipment, 84%; and tools, dies and molds, 87%. Machinery rates in specific sectors are as follows: food and beverages 67%; chemicals and pharmaceuticals 71%; construction 90% ; and clothing and textiles 76%.

The decision to take the present value deduction must be made in the month the asset is put into use. There is no longer a fixed time for which assets must be kept to qualify for the deduction. Also, there are no Mexican equity requirements to qualify for the present value deduction.

8.05 Schedule for paying taxes. Taxpayers are required to make advance payments on the seventh day of every month, based on assumed income computed by comparing the previous year's ratio of taxable profit to gross revenues with the current year's gross. This rate is applied to monthly income, including inflation gains. Under the new system, the previous year's profits and losses are adjusted by the inflationary component of the assets and liabilities. This can change a loss into a profit and hike monthly payments if the inflation component of the liabilities is higher than that of the assets. Tax payments must be based on a full 12-month period.

Income derived from monetization of Ceprofi tax credits in 1983 through 1987 is considered income for purposes of calculating provisional payments. This regulation also affects calculation of the profit factor for the preceding year. Since 1984, companies have been required to make estimated tax payments in their initial year of operations equal to 42% of any dividend income received. No advance payment is required if companies incurred a loss the previous tax year. Firms can apply for a reduction in provisional tax payments no later than 15 days before the payments are due. A final payment must be made three months after the end of the tax year. Interest on overdue tax liabilities is now charged at a rate of 8.5% per month if a delay in payment has been approved. If no delay is granted, the rate jumps to 12.75%.

The government may challenge tax returns up to five years after their filing and up to 10 years under certain circumstances that may apply to small, family-run businesses. In practice, however, the tax authorities generally check returns for the most recent fiscal year and for the subsequent period up to the time of the examination. Additions to the tax law stipulate that if errors discovered in any single tax category exceed 5% of official calculations of tax liability, authorities may audit companies' books from the previous five years.

Taxpayers have five years to file amended returns when refunds are anticipated. If the refund is not made within four months of filing, it accrues interest. Accounting firms indicate, however, that companies seldom benefit from this provision.

8.06 Excess profits tax. None.

8.07 Capital taxes. None.

8.08 Capital gains taxes. Corporate capital gains or losses arising from the sale of fixed assets are treated as ordinary income or losses and are taxed at the normal rates. Firms relocating from the Mexico City metropolitan area to certain zones slated for development are entitled to a tax rebate on gains resulting from the disposal of real estate.

A formula introduced in 1981 allows companies to adjust asset values to reflect inflation when calculating the tax on gains arising from the sale of land, buildings, shares of stock, and other capital interests. The amount of adjustment permitted varies according to the number of years the asset is held (see box on p. 22); these factors were increased substantially in 1984. Capital gains resulting from the sale of publicly traded stocks by individuals are tax-exempt.

8.09 Taxes on dividends. Since Jan. 1, 1983, dividends paid by one Mexican corporation to another have been included in the recipient's taxable income, except when such dividends are received in the form of shares or are reinvested in the payor within 30 days. No withholding tax applies to these payments (see also 8.03).

Mexican companies that distribute dividends in cash or in kind to resident individuals and nonprofit organizations and to foreign recipients (both corporations and individuals) must withhold 55% of the gross amount and pay this tax to the government. With certain exceptions, resident individuals may credit the amount withheld against their income tax due (9.00).

The 55% withholding tax is not charged and the distribution is not deductible on (1) dividends from retained earnings generated before end-1972, for which tax on distributable profits has been paid; (2) reimbursements of capital reserves on which the tax mentioned in (1) has not been paid (the distribution of such retained earnings is subject to a 15% withholding tax); and (3) reimbursements of capitalized profits from 1973 to 1982 (a 21% withholding rate also applies in this instance).

8.10 Taxes on interest. A 15% withholding tax rate applies to interest paid to foreign banks and financial institutions registered with the Secretariat of the Treasury. Interest paid by Mexican financial institutions to foreign creditors, as well as that paid on negotiable instruments to recipients abroad, is subject to withholding at 21%. Also taxed at 21% are loans to finance the purchase of fixed assets, and inventory (even if the credit is not extended by the supplier), along with loans to provide working capital.

Other types of interest payments, including those on loans from foreign parents to their Mexican subsidiaries, are charged a tax of 42%, withheld at source. Treasury officials have moved to prevent the use of intercorporate loans as a means of remitting profits without paying full taxes or of circumventing other tax regulations.

Several options exist for taking interest payment deductions on peso credits from both the old (April 1983) and the new Ficorca program. Firms can deduct the interest paid to Ficorca as payments are made, or they may opt to subtract—for tax calculation only—the amount of additional credit extended by Ficorca to cover those interest payments from the interest paid in a given year. The company is thus allowed to deduct the interest subtracted from the initial deduction when it begins to pay the additional peso credit. A previous limit on deductible interest to two points over LIBOR was dropped in 1984. Under the new tax system, interest is reduced by the inflationary component of the debt, thus limiting the amount that can be deducted.

8.11 Taxes on royalties and fees. Payments abroad for the use of models, plans, formulas, know-how and technical assistance are subject to a 21% withholding tax. Royalties paid to foreign licensors of patents, trademarks and trade names are charged withholding tax of 42% (see also 6.04).

8.12 Tax treaties. None.

8.13 Taxation of headquarters companies. Corporate regional headquarters and offices theoretically are taxed only on income generated in Mexico, at the normal rates.

8.14 Turnover, sales and excise taxes. The general VAT rate is now 15% (up from 10% in 1982), except in the border areas and the free zones of Baja California, Baja California Sur and northern Sonora, where it remains 6%. The VAT on real estate transactions in the border regions was also upped from 10% to 15%. In addition, a special 20% rate was introduced for luxury goods and services; all medicines and most foodstuffs are to be charged 6%; and professional services, except those of doctors, are subject to the general rate.

The following items are exempt from VAT: certain basic foods; machinery and equipment used in agriculture, fishing and livestock raising; fertilizers; land and residential buildings; books and periodicals; share transfers; and such services as public transportation and education. Exports are also exempt; producers of exported goods and manufacturers of machinery and equipment for the agricultural and livestock sectors are eligible for a credit or refund of tax in all stages of production.

Imports used to manufacture exports are also free of VAT. Companies can apply for a VAT waiver at the Secretariat of the Treasury (Hacienda). Because this procedure is extremely time-consuming, firms generally prefer to pay the VAT on their imports and either credit this outlay against their overall tax return or file for cash rebates on a monthly basis. As of 1987, firms must follow more complex procedures to obtain VAT refunds when they have made excess payments.

Companies may credit excess VAT payments against income or other tax payments. If within three months the excess cannot be credited in its entirety, firms can apply for a refund. The Secretariat of Hacienda must grant certificates validating the VAT credits. Nonexporters may only apply for credit approval on a monthly basis. Exporters are eligible for three-month credit certificates, based on estimated excess VAT payments. Heavy penalties exist for understating VAT liability.

The VAT is levied at each stage of production and distribution, and producers credit the entire VAT against the amount they will collect from purchasers. The actual tax payable at each stage is the difference between what is paid to suppliers and what is collected from buyers; it reflects only 15% of the value added during that stage of production. For imports, the VAT is based on customs value plus tariffs. As of Jan. 1, 1986, retailers have been required to incorporate the VAT into their shelf prices. This does not affect VAT taxation procedures throughout the production and distribution chain.

Companies must settle with the tax authorities monthly, making their payments by the 10th of the following month. VAT payments to Hacienda for installment sales can be made when principal and interest payments are actually received, not when the sale is invoiced—provided half of the purchase price is paid after six months (35% of the price for final consumer sales).

A special tax on production and services is charged to manufacturers and wholesalers of selected goods, which include soft drinks, alcoholic beverages and tobacco. This tax is levied on the different production and sales stages but, unlike VAT, it is not charged to the consumer. The tax varies by product and ranges from 3% on life insurance to 139.3% on cigarettes. A 1984 incentive exempts bottlers with no ties to foreign interests (including trademarks) from part of the tax, which is 15.7% in that industry.

New automobiles, mobile homes and certain other types of vehicles are subject to additional sales taxes. The recent tax amendments abolished the exemption for low-priced vehicles, and the law now provides for monthly indexation of new vehicle sales taxes based on average vehicle price. Rates range from 5% on a car worth P3.9 million to 18% on a car in the P5.9 million range. Most new cars are in the 13–18% bracket. In 1989, the top rate is scheduled to jump to 20%.

Purchases of real estate are taxed at a rate of 10% of the value of the property after a total of 10 times the annual minimum wage prevailing at the location is deducted.

8.15 Other taxes include a 1% levy on total monthly salaries payable by all employers; workers pay another 1%. A 5% payroll tax supports worker housing (12.05), and an export tax is applied to some commodities, such as oil.

Special taxes were levied to aid in reconstruction after the September 1985 earthquake. These included increased taxes on new automobiles, gasoline, alcoholic beverages, including beer and wine, tobacco, and telephone service. An additional 10% tax was imposed on wage earners in the highest income brackets (over P3.98 million), but this was suspended in 1987.

9.00 PERSONAL TAXES

9.01 General. One of the government's goals is to ease the tax burden on lower-income individuals. To qualify as a low-income taxpayer, a person must meet certain requirements, some of which were modified under the 1982 tax law amendments. Minimum-wage earners are entirely free from income tax, and only persons receiving salaries in excess of five times the yearly minimum wage in effect in their place of residence must file annual income tax returns.

Rates for high-income earners continue to climb. In 1987, a new 55% top rate for those earning P64 million was instituted. Income brackets are adjusted for inflation annually, however, to avoid bracket creep.

Of the recent changes in the personal tax structure, the most significant is the application of a compulsory system of withholding on dividend income. Under the rules issued in 1982, companies must retain 55% of the gross amount of dividends distributed to resident individuals; such recipients must include the gross dividend in their taxable income and are allowed a corresponding tax credit for the 55% withholding tax (see also 8.03 and 8.09).

Business enterprises making payments to individuals for fees must withhold a 10% tax. Companies making rent payments to individuals must withhold 20%; the tax and a statement including information about the payments made must be filed with tax authorities in February of the following year.

9.02 Persons liable to tax. Mexican citizens and resident aliens are required to pay Mexican taxes on all income regardless of source (but this is seldom enforced for resident aliens earning foreign income). Foreign nationals residing full-time in Mexico enjoy the same rights as citizens, except that they may not vote; they also incur the same responsibilities. Resident or *inmigrado* status may be obtained after five years' residence. Nonresidents (foreigners with qualified resident status of *inmigrante*) pay taxes only on their Mexican-sourced income; nonresidents on temporary assignment in Mexico pay a flat 30% tax on all income earned there.

9.03 Determination of taxable income. Taxable income includes remuneration for personal services rendered by an employee or professional, return on capital investment, and dividends, royalties, etc., after certain deductions.

Personal deductions are limited to (1) the equivalent of the annual minimum salary in the region; (2) medical and dental fees and hospital expenses incurred by the taxpayer, spouse or other dependents with income no higher than the annual minimum salary; (3) funeral expenses not exceeding the minimum annual salary; (4) certain donations; and (5) deposits into a special savings or retirement account up to a maximum of two times the yearly Mexico City minimum wage.

In addition, pension, disability and death benefits are tax-exempt unless they exceed 10 times the legal minimum salary for the region. Severance-payment benefits are exempt if they amount to less than 90 times the daily base salary of the region times the number of years employed.

Taxpayers whose income is composed of professional fees may not take a standard deduction for operating expenses; they can deduct only provable, "strictly necessary" expenses. Expense-account deductions must be documented, as must the difference between the market and sale price of shares bought under stock-option plans.

Individuals are given some relief from the effects of inflation when calculating capital gains. Taxpayers may increase their historical cost of land, buildings, shares and other capital interests by a multiple ranging from 1.00 for an asset held one year to 321.48 for an asset held over 49 years (see the box on p. 22).

The historical cost must be reduced by an accumulated depreciation at a rate that varies with the type of assets.

The difference between the historical price determined according to the above formula and the selling price is the net taxable capital gain. Through 1982, 20% of the net taxable capital gain was added to other taxable income in the annual return, and the tax for the remaining 80% was levied at the rate that resulted. Under certain conditions, losses arising from the sale of real estate and shares were totally deductible from taxable income in the year of the loss, and any amount not so deducted could be carried forward and deducted from capital gains earned in the following three years.

Since 1983, however, the proportion of capital gains to be added to other taxable income in the annual return has been based on the number of years the asset was held. For assets held for 10 years or more, only 10% of the taxable gain must be added to determine the top income tax rate payable. The immediately deductible proportion of a capital loss now also depends on the number of years the asset was held. This proportion may be deducted from any kind of income declared for the year or from capital gains arising in the following three years. The amount of loss not deemed deductible will give rise to a credit against the tax on other capital gains earned that year or in the next three years. Capital gains resulting from the sale of publicly traded stocks by individuals are tax exempt.

9.04 Personal tax rates. Monthly income tax rates for 1986 are as follows:

Lower limit	Upper limit	Tax on lower limit	Percentage on excess
0	201,600	0	3
201,600	1,453,400	6,048	10
1,453,400	2,355,900	131,228	14
2,355,900	3,190,600	407,824	18
3,190,600	4,227,400	407,824	22
4,227,400	6,613,600	635,920	26
6,613,600	7,975,600	1,256,332	30
7,975,600	14,073,100	1,664,932	35
14,073,100	17,166,600	3,799,057	40
17,166,600	25,371,200	5,036,457	44
25,371,200	32,188,400	8,646,481	48
32,188,400	37,029,800	11,918,737	50
46,591,200	56,275,200	19,311,365	54
56,275,200	64,000,000	24,540,725	54.5
64,000,000	and up	28,750,741	55

The employer withholds provisional tax payments, but taxpayers must file personal income tax returns by end-April. The box on p. 23 shows what the tax burden would be for someone earning an annual salary equivalent to $35,000 or $50,000.

9.05 Capital taxes. None.

10.00 INCENTIVES

10.01 General. Mexico completely overhauled its incentives schemes in 1979, replacing scant tariff duty exemptions with generous tax credits and tailor-made programs. Ceprofis (*Certificados de Promocion Fiscal*) provide investment tax credits of up to 40% to majority Mexican-owned private firms that further certain national objectives.

Ceprofi incentives are available for new investments in designated areas and for job creation. Ceprofi credits for purchases of Mexican machinery and equipment are available to both Mexican and majority foreign-owned firms. Ceprofi tax credits are granted according to two major criteria: location and priority of the industry. The government has specified two high-priority categories that cover a wide range of manufactured goods. Generally, highest priority is given to the production of inputs for the agricultural, food-production and health industries. Manufacture of capital goods is also given top priority.

The three geographical priority zones range from the least-developed Zone I to Zone III-A, which includes the heavily industrialized Mexico City metropolitan area. Complete listings of the hundreds of cities that make up the regional priority zones are published in the *Diario Oficial*. Zone I incentives are the most generous. Tax credits of up to 40% of capital expenditure are available for investment in "micro-industries," defined as those that employ up to 15 people and have net annual sales of no more than P30 million. Credits of up to 30% exist for small industries and for medium-sized and large industries in the highest-priority sectors. The second-priority category provides credits of up to 20%. Job creation was given more attractive incentives under the revamped Ceprofi program.

The highest credit available to large companies is 30% of

Inflation-Adjustment Factors for Calculation Taxes on Sales of Certain Assets, 1987

Years held	Adjustment factor	Years held	Adjustment factor
0-1	1.00	25-26	183.55
1-2	2.15	26-27	191.63
2-3	3.44	27-28	201.01
3-4	5.46	28-29	211.47
4-5	9.89	29-30	224.16
5-6	19.65	30-31	241.64
6-7	25.30	31-32	260.73
7-8	32.85	32-33	291.24
8-9	39.41	33-34	324.44
9-10	45.80	34-35	325.04
10-11	55.23	35-36	358.44
11-12	70.26	36-37	422.95
12-13	78.20	37-38	438.60
13-14	94.31	38-39	448.69
14-15	114.39	39-40	450.48
15-16	120.81	40-41	486.52
16-17	126.84	41-42	641.72
17-18	133.18	42-43	668.03
18-19	141.17	43-44	919.21
19-20	144.70	44-45	1,071.80
20-21	148.90	45-46	1,169.33
21-22	156.50	46-47	1,177.52
22-23	160.41	47-48	1,237.57
23-24	170.36	48-49	1,266.03
24-25	177.34	49 or more	1,329.34

three times the annual minimum wage for the region, multiplied by the number of new jobs created. The number of jobs must be maintained for at least two years from the time the investment is made. All companies that buy new Mexican-made machinery or equipment that will become part of their fixed assets are eligible for a tax credit equivalent to 10% of the value of the purchase. Companies registered in the Capital Goods Development Program (*Programa de Fomento de Bienes de Capital*) are also eligible for a 10% tax credit for certain parts and components. Zone II incentives are identical for small and micro-industries and slightly lower for medium-sized to large companies. Zone III-B tax credits apply only to investments in industrial parks in the region. For medium-sized and large industries, these credits amount to 15% and 10% for first- and second-category sectors, respectively. Small companies can obtain a 20% credit for investment in Zone III-B industrial parks. A bonus equivalent to 30% of the existing tax credit is available for companies that start their new investment production on stream by Dec. 31, 1988.

Since both the degree of priority and the location of a project determine the amount of tax credit, firms planning to manufacture a Category I product in Zone I stand the best chance of getting top-of-the-line incentives (see the box on p. 24). The attractiveness of a project in terms of local sourcing, value added, job creation, balance-of-payments impact and vertical integration determines the investor's eligibility for priority classification. Majority foreign-owned firms are generally excluded from the tax-credit scheme; however, the authorities may make exceptions if a firm negotiates concessions on its local equity share.

10.02 Qualifying for incentives. Decentralization and diversification are major development goals, and, as noted above, the government awards incentives according to both criteria. The broad plan hinges on close cooperation between local administrators and federal authorities to designate industrial development priorities and desirable types of manufacturing. The states are to submit for federal approval a list of preferred municipalities and types of industry. Approved regions and industries are then published in the *Diario Oficial*.

10.03 Applying for incentives. To obtain a Ceprofi, a company must first apply to the Secretariat of Commerce and Industrial Development (Secofi) to obtain a priority classification for its project. The investment proposal must be accompanied by the firm's "development program." This should specify production targets, export potential, investment plans and local-sourcing possibilities.

Once Secofi has granted a firm a priority category assignment and the appropriate certificate—a procedure that should be completed within 30 working days of the request—it contacts the Secretariat of the Treasury (Hacienda), which has 15 working days to calculate the amount of tax credit. Hacienda will review the planned capital outlay for machinery, equipment and plant construction (if incentives are to be granted for new investment in installations or expansions).

10.04 Corporate tax incentives. Under the Ceprofi system, a company may obtain direct tax credits for purchase of Mexican equipment, for new investments or expansions and for job creation. Only majority Mexican-owned companies are eligible for the incentives. However, some foreign-owned firms have been able to negotiate relaxation of the ownership requirement. Foreign-owned companies qualify for the incentive to purchase Mexican-made equipment.

The highest incentive, a 40% tax credit, is awarded for new investment by a "micro-industry" in either Zone I or II. In medium-sized to large industries, the largest credit—30%—goes to first-priority industries in Zone I. Second-priority industries in this zone and first-priority sectors in Zone II qualify for a 20% tax credit. An additional credit is available for job creation, equivalent to up to 30% of the number of jobs, multiplied by three times the annual minimum wage of the region. The box on p. 25 gives a breakdown of the incentives granted according to regional and sectoral priorities. Ceprofis can be credited against any federal taxes. Special tax incentives granted to specific industries should be announced when their respective sectoral plans are issued.

An investment Ceprofi is good for five years. A charge of 4% of the tax credit is levied to cover costs of inspection. If a company fails to carry out its investment program, Hacienda will rescind the Ceprofi, and all unpaid tax falls due within 15 days. Sometimes Ceprofis may be used by other companies within the same group as the firm that is entitled to the credit. A special ruling is needed to transfer the tax benefit.

Tax credits for employment are much easier to obtain than investment Ceprofis. Firms creating jobs through new industries or expansions qualify for a credit, depending on the zone, of up to 30% of the annual minimum wage, multiplied by the number of jobs generated. The credit is good for one year only, and the new jobs must last for at least two years. Ceprofis cannot be combined with other tax incentives, and in recent years many companies have opted for the attractive depreciation allowance rather than investment Ceprofis.

Firms in the highest-priority areas that are already eligible for Ceprofis may qualify for an additional 5–10% tax credit if the new investment generates significant new employment. However, the raise will be approved only if efficiency, competitiveness and other criteria of the appropriate industrial development program are fulfilled. Nonpriority projects are excluded

Personal Taxation in Mexico

Below is an example of the personal tax burden on a married employee who has two children and who earns the equivalent of $35,000 or $50,000 (P42 million or P60 million, respectively, at a rate of P1,200:$1) in 1987, all of it remuneration for services.

(1) Salary	P42,000,000	P60,000,000
(2) Deductions:		
Annual general minimum salary for Mexico City plus an additional month's income, i.e. yearly bonus (P61,950) times 13 months)	1,427,400	1,427,400
Medical expenses	850,000	650,000
(3) Total deduction	2,277,400	2,277,400
(4) Taxable income	39,722,400	57,722,600
(5) Tax payable before surcharge	15,739,589	25,329,558
(6) Effective tax burden	37.5%	42%

Mexico's Sectoral Priorities

Category I

Basic goods: Natural milk, cream, butter, cheese; packing, packaging and processing of meat or fish; soy and wheat flours; cookies, crackers and pastas; white and whole bread; corn flour and tortillas; vegetable oils, greases and lards; processing of fruits and vegetables; salt and sugar; manufacture of nutrients for food preparations; fish meal and fish flours; feeds and chemicals for livestock; chemicals derived from agro-livestock, forest or marine development; cellulose; finished wood products and parts manufacture of nutrients for food preparations; fish meal and fish flours; feeds and chemicals for livestock; chemicals derived from agro-livestock, forest or marine development; cellulose; finished wood products and parts manufactured at integrated forestry plants; veterinary medicines, pharmaceutical products and raw materials for the basic list of medicines.

Capital goods: Machinery and equipment for food processing; wheeled tractors, harvesters, farm tools and crop-duster planes; machinery and equipment for petroleum prospecting and drilling and for petrochemical industries; valves, valve trees, pumps and connections; motorpumps, motorcompressors, turbocompressors and blowers; pipelines for drilling, collection and processing; tubular heaters; machinery and equipment for electric generation, conduction and distribution of high-voltage electricity; hydraulic, steam and gas turbines and electricity generators; injection pumps and high-capacity boilers; machinery and equipment for mining, concentration and processing of minerals; coking machinery and equipment, pelletization or smelting of ferrous minerals; foundry, casting or lamination of metals and for manufacture of metal products using sheets, rods or wires; machinery and equipment for construction, earth moving and grading; manufacture of diesel engines and parts, trailer trucks, medium- and semi-heavy trucks, trolleybuses, buses, nonsport boats and parts, locomotives, railroad cars, equipment and heavy installations; machinery and equipment for other industries including machine tools, carbon, steel and alloy steel pipe, pumps, valve bands and connections for manufacturing; industrial controls; laboratory and measuring instruments; high-power DC and AC electric motors and controls; machinery and equipment for cement manufacture, paper and cellulose industries; foundry, castings and moldings for machinery and equipment manufacture using iron and steel and alloys; heavy welding and soldering equipment; electronic telephone exchange systems and switchboards, professional and industrial electronic communications equipment and parts, electronic computation systems, general use electronic integrated circuits and parts; machinery and equipment for handling merchandise; machinery and equipment for packaging and bottling; antipollution equipment; machinery and equipment for water wells; speed reducers for industrial use; metal molds, dies and casts; electronic measuring and control equipment.

Category II

Consumer nondurables (all for low-income consumption); Leather, cloth or plastic shoes; threads, clothes and textiles from cotton and artificial or chemical fibers; bleaching, stretching, preparation and processing of cloth and textiles for the manufacture of clothing; hide tanning; soaps and detergents; paper and cards, cardboard; glass, plastic or tinplate food packaging; paper and school supplies, textbooks and encyclopedias.

Consumer durables: Electric appliances and furniture for low-income consumption; automobile parts; popular bicycles and motorcycles; optical equipment medical and hospital equipment and instruments; telephone equipment and accessories; hand tools; industrial security, safety equipment; equipment and materials for electricity transmission, electric cables and conductors; computing, e.g. computing equipment and parts for office use.

Intermediate goods: Fibers derived from petrochemical products; intermediate petrochemical products; synthetic rubber, plastic resins and their raw materials; basic inorganic acids and salts; chemical specialties from coal coking and coal tar distillation; sodium and potassium alkalies; metallic silicons and intermediate monomers of organic silicon products; chemicals and products derived from nonmetallic minerals; aluminum smelting and refining; smelting, refining, casting and lamination of nonferrous metals, their alloys and special steel; casting, lamination and relamination of iron, steel and their alloys; plate glass and its plastic products for construction; bricks, tiles, clay products; cement-based construction materials; bathroom fixtures and furniture made from clay, tile or porcelain for use in low-income housing; agglomerated wood sheets and plywoods; refractories and abrasives.

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from the tax credits but may garner a 20% employment benefit if various conditions are met.

A 1982 decree hiked the Ceprofi for job creation through new investment from 20% to 80% depending on the firm's location and industrial activity. However, firms are only eligible for this incentive if they relinquish the generally more attractive tax credit that corresponds to the value of investment in fixed assets.

Investors in border zones may opt for Ceprofis on new investment, job creation and purchase of Mexican-made equipment or duty exemptions on imports of machinery, equipment and spare parts calculated according to the percentage of local content. Unlike in-bond activities, these investments can be geared toward producing for the domestic market, provided companies justify that domestic sales generate a favorable foreign exchange balance, replace imports on a national scale or have content equal to the average local content of similar products made elsewhere in Mexico. Ownership must be at least 51% Mexican.

A February 1985 decree revamped Mexico's relocation incentives. The new decree makes available several Ceprofis for majority Mexican-owned firms moving out of the Mexico City metropolitan area into priority Zones I and II and a number of industrial parks in Zone III-B. To be eligible for these tax rebates, a company must completely close operations in Zone III-A within three years of the date the relocation program has been approved by Secofi.

The highest tax credits are given to a number of polluting and water-intensive industries that relocate (see the box on p. 26). These preferred relocation firms are entitled to a 100% tax rebate on the capital gains derived from the sale of buildings and land, provided the proceeds are reinvested in the new industrial installations within two years of the sale; the tax rebate is 75% for other relocating companies.

If the relocation involves the establishment of a new company, proceeds may also be invested in shares of that new firm as long as these shares are held by the tax credit beneficiary for at least five years. This incentive also applies to firms that sold fixed assets as of Jan. 1, 1982, provided they fulfill all the other relocation requirements. In addition, preferred industries may receive a Ceprofi equivalent to 20% of the replacement cost of machinery and equipment transferred to the new location. The incentive drops to 15% for other firms. Preferred industries also receive a tax credit equivalent to 20% of moving expenditures, including mechanical and electrical installations; the Ceprofi is 15% for nonpreferred companies.

All majority Mexican-owned firms relocating from Zone III-A to industrial parks in Zone III-B are entitled to tax credits equivalent to 10% of machinery and equipment replacement cost, 50% of the capital gains on fixed assets sales and 10% of

Tax Credits Under Mexico's Incentives Schemes

Percentage rates refer to the amount of the tax credit for new investment, job creation or equipment purchases. In the case of investment, the credit applies to the total approved capital expenditure. In the case of job creation, the credit applies to the total number of new jobs created during the first year, multiplied by three times the area's annual minimum wage.

Location	Microindustries[1]	Small industries[2]	Priority industries: Priority I	Priority industries: Priority II	Purchase of Mexican equipment
Zone I	40%	Investment and jobs–30%	Investment and and jobs–30%	Investment and and jobs–20%	10%
Zone II	40%	Investment and jobs–30%	Investment and and jobs–20%	Investment and and jobs–15%	10%
Zone III-A	—	—	—	—	10%
Zone III-B	30%	Investment and jobs–20%[3]	Investment and jobs–15%[3]	Investment and jobs–10%[3]	10%
Rest of country	30%	Investment and jobs–20%	Investment and jobs–15%[4]	Investment and jobs–10%[4]	10%

(1) Microindustries are those that employ up to 15 people and have annual sales of up to P40 million.
(2) Small industries are those that employ 16–100 people and have annual sales of P40-500 million.
(3) Only in industrial parks.
(4) For expansions only.

moving expenditures.

10.05 Personal tax incentives. A tax-deductible personal savings plan has been available to individual depositors since 1984. Formerly, these deposits had to remain untouched for one year to be tax deductible, but the latest tax changes stipulate that funds may be withdrawn, in which case a withholding tax of 21% will be levied on deposits made in 1984 and 55% on funds deposited after Jan. 1, 1985. These special accounts currently pay 50.3%, which is several points over the highest peso deposit yield.

10.06 Tariff incentives. Authorities only recently began to revive the virtually abandoned system of import duty exemptions. The industries to benefit from these incentives are automotive manufacturers and companies in priority industries, including producers of basic foodstuffs, consumer goods for low-income households and various intermediate manufactured goods (e.g. fibers derived from petrochemicals, synthetic rubber, plastic resins). Also eligible are producers of specific chemicals and capital goods. Car manufacturers can obtain duty exemptions on machinery and equipment for new investments or expansions, provided the goods cannot be purchased locally.

Exemptions range from 50% to 100%, depending on product line and plant locations. The imports must be used to manufacture new products that increase either local content or exports in new plants outside Zone III or in expansions of existing plants outside the Mexico City metropolitan area. The duty waivers may not be combined with other fiscal incentives, such as accelerated depreciation. Producers of priority goods may import raw materials, components and spare parts duty-free, or at reduced rates, if imports cannot be obtained locally or if domestic suppliers are unable to fill the order on time. If the prevailing duty is 10% or less, a reduced tariff rate will not be granted.

10.07 Capital incentives. Mexico offers a vast array of special funding programs that grant preferential financing for priority activities. Emphasis is given to development in the same priority zone used for granting tax incentives. Most of the credits are funneled through commercial banks. Some firms have complained that the red tape involved in obtaining these soft loans can be time-consuming. To be eligible for funding from most of these official trusts, companies must be 51% Mexican owned. Fonatur, the tourism development fund, and Fomex, the export credit line, are about the only preferential funds that majority foreign-owned firms have easy access to. Fira will also provide export funds to majority foreign-owned firms that are agricultural and livestock exporters.

Government officials are showing some flexibility in this area, however, and firms carrying out high-priority projects may find they can get special approval. In the past, majority foreign-owned companies have been able to tap Fonep (Fonda Nacional de Estudios y Proyectos), which is supported by funds from the Inter-American Development Bank, for financing of feasibility studies, but this has now been closed to majority foreign-owned firms. Mexican consulting firms hired by majority foreign-owned firms can apply for the funds, however. Eligible firms may receive direct financial assistance from these funds, although their low-interest loans are also channeled through banks. Fonep's and Fomex's special programs must be applied for through regular commercial banks. Firms have traditionally complained about the red tape involved in obtaining these preferential credits.

Rates on these credits are based on the bank's cost of lending (*costo promedio percentual*—CPP, according to the industrial sector—with the lowest rates going to priority industries), size of the company (measured through sales and number of employees) and geographical location of the project. Preference is given to the least industrialized areas, and officials will take into account the effect of the project on the nation's priority goals:

Mexico's Preferred Relocation Industries

Mexican authorities would like to move the following industrial activities out of the Mexico City metropolitan area:

- Food processing; processing of cereals and other grains and dairy and wheat flour products; slaughtering and packaging of meat.
- Alcoholic and nonalcoholic beverage production; breweries.
- Textile products; manufacturing of bland and hard fiber threads and fabrics.
- Leather industry.
- Paper and cardboard industry; manufacturing of cellulose paste.
- Chemical industry.
- Fertilizer, pesticide and basic chemical substance production.
- Synthetic and artificial resins and paints and lacquers production.
- Basic petrochemical production.
- Crude oil refining.
- Pharmaceutical and personal care industry.
- Manufacturing of nonvegetables and animal oils and greases for industrial use.
- Mineral carbon and asphalt mixtures.
- Rubber and plastic industry.
- Manufacturing of china, clay and porcelain products.
- Glass industry.
- Manufacturing of clay products used for construction.
- Cement, lime and chalk industry and manufacturing of other nonmetallic minerals.
- Basic steel, iron and nonferrous metal industry.
- Other metal products except for machinery and equipment.
- Automotive industry.

exports, basic goods production, import substitution and local technological development.

Rates have been climbing steadily since 1985. Credits that were available for as little as 55-65% of CPP now range upward to CPP. While Fomex export credits will only increase slightly in real terms, major increases are budgeted for most other development loan programs. These loans have taken on additional attractiveness because of their full deductibility of interest under the new tax system.

Mexico has a wide scope of trust funds managed by development banks such as Nafinsa and Banrural. In line with the National Development Financing Program, these funds will gradually move away from providing working capital and move toward risk capital to finance projects in priority industrial areas and relocations. The funds will increasingly take temporary minority partnership.

The Fondo Nacional de Fomento Industrial (Fomin), operated by Nafinsa, will temporarily take minority equity in new or expanding industries, particularly those established outside industrially congested zones. Fomin usually assists small and medium-sized companies. Participating firms must be majority Mexican held. Fomin contributes risk capital in return for preferred shares, up to 49% of the capital stock of companies whose activities promote regional development or who use or develop local technology. In 1987, Fomin has a budget of P26 billion. It also makes loans at CPP to CPP plus 3 through acceptance of subordinate convertible paper; the rate depends on the industry priority and priority of the geographical zone.

The Fondo de Garantia y Fomento a la Industria Mediana y Pequena (Fogain) makes inventory and industrial-equipment credits available to majority Mexican-owned small and medium-sized manufacturing companies. To qualify, firms must not employ more than 250 people or generate more than P2 billion in sales. Inventory loans are available at terms up to three years, with rates from 85% of CPP to CPP, depending on size of the firm and geographic location. Fidein, the fund for the development of industrial complexes, supports small- and medium-scale industrial operations ranging from the subdivision of industrial parks to long-term financing for purchasing factory buildings, machinery and equipment. In 1987, loans were available up to P500 million, with maximum terms of 12 years and a grace period up to the time required for construction, not to exceed 18 months. Rates vary from 75% of CPP to CPP.

The tourism fund, Fonatur, also falls under Nafinsa's jurisdiction. The fund makes available inventory and industrial equipment credits to majority Mexican-owned firms investing in construction, expansion or remodeling of hotels and other tourism-related projects. Terms range from three to 15 years; up to 60% of the total amount of a given investment can be covered. Rates vary from 72% to 95% of CPP depending on the ranking of the hotel. Rates for time-share condominiums are a bit higher at CPP plus 0.04. Fonatur also has a special credit program for repair of earthquake-damaged hotels, with rates running 65% to 88% of CPP. Tourism-related food and beverage facilities can be financed at CPP plus 0.04 as well. In some cases, a grace period for principal and interest payments is available for the period of construction. Fonatur also makes direct investments in hotel projects, mainly through joint ventures. In 1986, Fonatur provided P81.5 billion in joint-venture funding to projects worth a total of P137 billion. In 1987, Fonatur has a budget of P92 billion, most of which is traditionally allocated to direct investment in Mexico's tourism development areas. Under study is a new program to provide financing to set up travel agencies, guide offices and car rental agencies.

The industrial equipment trust fund (Fonei), operated by the Banco de Mexico, provides long-term financing to majority Mexican-owned enterprises for up to 13 years. Financing for individual projects cannot exceed P3 billion.

Fonei makes financing available for purchase of equipment, with the focus on industrial reconversion, feasibility studies, R&D, pollution control and working capital. The decision to grant a credit is based on the feasibility of the proposed projects.

In 1987, Fonei has P213.5 billion available. Some P139.4 billion has been allocated for long-term (up to 13 years) equipment financing at CPP plus three. Loans up to eight years at CPP plus three are available for optimization of installed capacity; a total of P2.7 billion is available for this type of project. A total of P36.1 billion has been allocated for long-term R&D loans of up to 13 years at 94% of CPP. For pollution control efforts, P7.9 billion is available at 94% of CPP. A working capital fund of P23.8 billion to provide working capital loans at CPP plus four over three to seven years is also available. A total of P465 million has been allocated for financing feasibility studies. Terms are up to eight years at 94% of CPP.

Another attractive source of official financing comes from the National Fund for Studies and Projects (Fonep), administered by Nafinsa. The fund finances feasibility and prefeasibility studies.

List of Strategic Capital Goods

Purchases of the following capital goods are entitled to a 15% Ceprofi:

Construction equipment and machinery: industrial caterpillar tractors over 300 hp, motor plows over 200 hp, self-propelled vibrating compactors, backhoes over 85 hp.

Equipment and components for industrial electronics: microcomputers (complete systems), minicomputers (central processing units), video terminals.

Environmental protection equipment: closed solid waste management systems, complete gas treatment systems, complete solvent recovery systems, packet water treatment plants.

Machinery and equipment for the food industry: separaters and sifters, humidifiers.

Petroleum machinery and equipment: petroleum-drilling machinery, equipment and rigs; marine petroleum-drilling platforms; equipment for movable tubing, gyrating coupling, rotating base, hook and travalling block; mud pumps.

Electric machinery and equipment: AC electric motors of over 1,000 hp; DC electric motors of over 100 hp; switches for tensions over 34.54 kv; variable speed for DC electric motors of over 100 hp; hydraulic, steam and gas turbines; electric switches for tension from 13.8 kv to 400 kv; electric transformers for tension from 34.54 kv to 400 kv; electric measuring equipment such as wattmeters and Vahrmeters for multiple use.

Machinery and equipment for the mining and metallurgy industries: movable scaffoldings, laminating equipment for the steel industry, continuous forging equipment; flat roller laminators.

Equipment for the naval industry: glass fiber, ferrocement or wood fishing and shrimp boats up to 100 ft long; depot ships from 100 to 250 ft; general cargo ships, container and tank ships; tow boats, ferries, stationary dredges, maritime signaling ships, research and training ships.

Machine tools: machines for metalworking, standard vertical and semiautomatic lathes, grinding machines, standard vertical and horizontal milling machines, drills, tapping machines, gear generators, transfer machines, machining centers; mechanical and drop forge presses; mechanical and hydraulic shears; high-capacity (over 300 tons) hydraulic presses.

General machinery and equipment: casting machinery for the glass industry; concrete pumps; centrifugal pumps over 1,000 hp and compressors; compressors with a capacity over 1,500 cu ft per minute; forged, stainless steel and alloys valves with diameters over 12 inches; condensors with over 1,000 meters of surface; steam boilers over 20 Mw; heat exchangers with over 1,000 meters of surface; heavy-duty travalling cranes and hydraulic truck cranes; winches with a capacity over 20 tons; sugar mills; arc and standard ovens.

In 1987, interest charged was 70–90% of CPP, plus a 1% commission for inspection and control. Terms of Fonep loans range from one to four years with one year's grace. In addition to financing studies, Fonep provides financing to consulting firms. Credits ranging from 70% to 90% of CPP are available for working capital, acquisition of fixed assets and technological development. Only majority Mexican companies are eligible.

Organizacion Somex is a semiofficial source of both loan and equity capital. Majority-owned by the Mexican government, Somex includes a banking and an industrial division. Banco Mexicano Somex became a national credit company according to the 1982 banking law. Interest rates follow prevailing levels. In the past, Somex has proved an excellent joint-venture partner for some foreign companies, including Fairbanks, Morse, Nikko, Amoco, Atsugy Motor Part Co, Colt Industries, ITT and Ciba-Geigy. However, Somex has begun to reduce its participation in companies. All banks are required to keep their equity participation limited and not hold a stake in a company for more than five years.

Several large parastate companies make credits available to their suppliers through development banks. Pemex, in conjunction with Bancomext and Fomex, offers two programs to firms that manufacture goods contributing to import substitution. CFE, the national electric company, makes credits available through Bancomext as well to majority Mexican-owned capital goods suppliers. Access to these credits should improve in 1987 with the arrival of fresh financing. Interest on supplier credits is payable quarterly at CPP plus two. Terms are decided case by case. Bancomext will finance up to 70% of the order up to a maximum of P1 billion. Total funding given to one single supplier may not exceed P1 billion, and suppliers that opt for this financing will not receive advance payments.

Occasionally, states offer additional capital incentives. San Luis Potosi, for example, has been known to provide land for industrial investors.

10.08 Research and development incentives. The 1980 incentives plan for local research and development is no longer applied by the government.

11.00 CAPITAL SOURCES

11.01 General. Mexico's highly developed banking system was in private hands until it was nationalized in September 1982. Ex-shareholders were paid through government-sourced indemnization bonds with a 10-year maturity. These bonds are negotiable on the stock market. In accordance with a new banking law, Mexico's 66 banking institutions were consolidated into 29 national credit companies. The Finance Secretariat (Hacienda) exercises considerable control over these credit companies. Two types of shares have been issued: series A, which consists of 60% of the capital and is held by the federal government; and series B, which is sold to the general public, provided that a purchaser—who must be Mexican—buys no more than 1% of the total equity. In early 1987, Mexican banks began making public issues of the series B stock. Up to 34% of total national bank stock will be privatized this way. Most of the stock was placed privately with bank employees and prime customers in 1986, however. The small amount that remains is only available at inflated prices. This stock is nonvoting, and no individual or company can own more than 1%.

In December 1984, Mexico made a number of crucial changes in its banking legislation as part of a total reorganization of the financial sector. The changes, which took effect Jan. 1, 1985, more clearly define the sphere of influence of the nationalized banks and the role of private initiative in the country's financial sector. The number of banks will eventually be trimmed from the present 29 to 17. Only the five largest banks will continue to provide nationwide coverage, while the smaller institutions will be limited to regional operations.

Technically, banks are required to set aside 10% of deposits for the legal reserve and another 65% for an obligatory loan portfolio of funding to priority areas such as housing and agriculture. However, starting in July 1985, the central bank capped the amount of new funds available for private sector lending at around 10%. The Banco de Mexico directed commercial banks to put aside virtually all otherwise uncommitted new deposits over the June level toward the purchase of government bonds. This was announced as a three-month measure to restrict liquidity, but it has been continued through first-half 1987. As a result, bank credit to the private sector has been essentially limited to funds available from repaid loans over the past 18 months. Credit to the private sector in 1986 was down 17.2% compared with 1985. There are some signs of increased loan availability in 1987, however, due to slack demand for financing and repatriation of capital, which has bolstered the central bank's reserves and taken a bit of pressure off the local financial markets.

11.02 Short-term credit. Commercial banks have traditionally provided most of the short-term credit in Mexico, but scarce bank financing in 1986 sparked a move toward banker's acceptances, commercial paper and *extrabursatil* commercial paper. Direct intercompany loans also became more common. In early 1987, the situation has begun to improve both in terms of bank financing availability and cost. This will no doubt lead to a return to use of bank credit by many firms.

Short-term credit, whether by secured or unsecured loans or discounting of trade acceptances, is limited by law to 180 days (except for financing exports of manufactured goods) but can be rolled over indefinitely for like periods. Mexican banks have been lending at 30 days, with rollovers allowed for up to one year, after which full repayment must be made and a new credit line put into effect. Some banks can be persuaded to extend unsecured credit; however, this concession is usually given only to prime firms with considerable financial strength.

Competition for business with Mexican brokerage houses, *casas de bolsa,* has led to elimination of upfront interest payments and often countervailing balances for prime firms. Smaller Mexican banks will still demand them, however. Thirty-day loan rates have fallen from CPP (*costo promedio percentual*) plus 15 in December 1986 to CPP plus five for top customers as of April 1987. Nevertheless, the effective borrowing rate remains around 160–170%.

The commission for rollover of a term loan is normally 1%. In addition, some banks charge a fee, also around 1%, for inspection of goods pledged as loan collateral. During times of large excess lending funds, banks have been willing to loan for very short terms, ranging from three to seven days, with an effective cost only a few points over CPP.

Bankers acceptances (BA) have been steadily gaining in importance. In 1987, use of the instrument balooned as Banco de Mexico encouraged banks early in the year to issue acceptances above 100% of their capital and deposit them with the central bank. This was done by hiking the interbank rate for such deposits. In the second half of the year, the central bank rate was lowered substantially, discouraging the practice. Nevertheless, banks have become increasingly sophisticated in providing bankers acceptance financing to firms, generally at BA plus 2–3. During 1986, bankers acceptances accounted for 33% of all market transactions. The number of offerings rose to 2,825, up 45% over 1985. Total value placed was P19 trillion—up 499% in real terms over 1985. In early 1986, BA rates were higher than Cetes. In the second half, rates fell, however, and during early 1987 were running at par or slightly below 28-day Cetes rates, at 93–95%. Companies can often obtain 28-day financing renewable for 90 days through bankers acceptances.

Firms also relied heavily on the commercial paper market in 1986. Commercial paper is denominated in pesos, with terms ranging from 15 to 91 days (28-day placements are most common). It is sold on a discount basis in notes of P100,000 through the stock market. The paper is unsecured, but the Comision Nacional de Valores (CNV) requires detailed information before it authorizes a placement. A secondary commercial paper market has not developed. One big reason is that brokerage houses have lacked the resources to take positions themselves.

The volume of commercial paper traded in 1986 increased by 449%. Peso value in circulation rose to P2.7 trillion. During the year, there were 610 new issues, worth P566.76 billion. This represents a 121% increase in the number of new issues and a peso value increase of 15% in real terms. The increase was largely due to the lack of credit availability through the banks. Rates have consistently risen because of competition with treasury bills (*Cetes*). Because of its higher risk, rates of commercial paper are above those of other instruments—at three to three and a half percentage points over the *Cetes* yield, with returns averaging three percentage points over bankers acceptance yields, according to Banco de Mexico's 1986 report. Brokerage houses charge a 1.75% commission, which is tax deductible. Nominal rates for commercial paper in May 1987 ranged between 96% and 98%. Companies issuing commercial paper in early 1987 included Kimberly Clarke, Almexa, Borden and Purina.

In addition to bolsa-issued commercial paper there is *extrabursatil* commercial paper, which is placed privately by *casas de bolsas* to companies and private investors. This paper averages 1–2 points above the cost of bolsa commercial paper but can be issued faster without extensive disclosure requirements. Operations with this paper totaled P1.7 trillion in 1986, an increase of 481% in real terms.

In April 1986, the National Stock Commission authorized a new instrument, the *pagare empresarial*, which combines the attributes of bolsa-issued commercial paper and those of the *extrabursatil* paper. Non-bolsa listed firms can issue the new *pagare empresarial* by meeting disclosure requirements similar to those for commercial paper. These notes are then placed by *casas de bolsa* in a manner similar to *extrabursatil* paper. Rates tend to be 1–2 points lower than those of *extrabursatil* paper because of strong disclosure requirements. In the first nine months of operation, there were 174 placements, with an overall value of P105.3 billion. (Rates on pagares, extrabursatil paper and commercial paper are based on a spread over Cetes.) The instrument was suspended in February 1987, however, at the request of the Finance Secretariat, which maintained that it encouraged offshore borrowing through back-to-back loans.

In 1986 through early 1987, the spread has been Cetes plus 3–5 points on commercial paper and Cetes plus 5–10 points on pagares and extrabursatil paper. MNCs with established *casa de bolsa* relationships have been able to place extrabursatil paper at Cetes plus five and in a few cases Cetes plus three.

Although the 1978 amendments to the banking law removed the obligation to secure lending, term loans must frequently be backed by *pagares* (promissory notes with return payable on maturity), inventory or mortgages on fixed assets. MNCs can often use offshore bank balances and foreign bank guarantees. A minimum 20% reciprocity is required, and in many cases banks will try for higher amounts. Until very recently, interest was always payable up front, but can now be negotiated because of the increased competition from the *casas de bolsas*. Some MNCs are also finding more flexibility on compensatory balances.

Companies can also get short-term 28-day loans through the *mesas de dinero* operated by the banks. These are trusts that operate like brokerage houses. Companies with lines of credit can borrow short term at the bankers acceptance rate plus two to three percentage points. Companies with strong bank relationships can often put up less than a 100% guarantee in Cetes, foreign bank balances or other liquid assets (*casas de bolsas*, in contrast, almost always require 100% guarantees). The brokerage houses are working to have these bank trust operations shut down, arguing that they are infringing on the law banning banks from running *casas de bolsas*.

11.03 Medium and long-term credit. Even when pesos are available for free lending, banks are reluctant to lend for periods exceeding 180 days. Most long-term financing is available only for equipment loans. Little change can be expected in the need to continuously roll over short-term loans. Domestic long-term borrowing usually requires a statement specifying the use of the funds, a provision for mortgage collateral and inspection by bank representatives every six months to assure that borrowed funds are being used as intended. In addition, banks ask for annual balance sheets and profit and loss statements for the preceding year or years, depending on the amount to be borrowed. Companies must also provide banks with sales projections, sometimes up to two or three years. However, requirements depend greatly on the client-bank relationship.

Exporters stand the best chance of tapping the paltry amount of longer-term funds that are available locally, especially since Mexico received a $500 million loan from the World Bank for export development. At the same time, Nafinsa is also offering long-term loans for technological reconversion at CPP plus 2–3. Mexico has reached its borrowing limit with the Inter-American Development Bank (IDB), thus ruling out what has been an important source of official finance.

Multibanks are the main source of long-term loans. The law limits the duration of such loans to 15 years, but it is extremely difficult to obtain pesos for more than three to five years. A parent guarantee may be required for foreign affiliates, although some large subsidiaries of multinational firms have secured loans without them. Nominal interest rates for medium-term loans and longer-term lending (over five years) are set according to CPP. As with all borrowing, effective costs are substantially higher once guarantees, commissions and interest payment schedules are factored in.

At present, credit institutions revise the spread on medium-term loans quarterly—or in some cases, semiannually. They may hike the premium if CPP does not accurately reflect their actual borrowing cost.

Some treasurers are willing to settle for a higher premium if the bank agrees to fix the spread for the entire lending period. They argue that this curbs the wild fluctuations in borrowing costs somewhat, thereby helping the company to project its financial expenditures over the medium term.

Inventory loans (*prestamos de avio*) are available for certain priority sectors, including exporting and agriculture. For the latter, basic crops such as corn and wheat qualify for selective credits. As of 1986, preferential rates were offered to low-income farmers. These rates range from CPP minus four to CPP minus five. Larger producers must now pay CPP plus five. Inventory loans are made for 12 to 24 months. Inventory loans for nonpriority sectors, when available, cost about the same as bankers acceptances.

Chattel mortgages (*prestamos refaccionarios*) for terms of up to 10 years may be granted only to industrial firms to cover purchases of machinery, equipment and other fixed assets. Cost is comparable to inventory loans.

Nafinsa (10.07) is a source of term loans for joint ventures that cannot raise sufficient funds from local sources. However, the state-owned institution expects private investors to provide at least 51% of the capital required. Export and import-substitution industries stand an excellent chance of obtaining financing from Nafinsa.

Another way to finance equipment and machinery is through equipment-leasing companies. Most important among these are Interamericana de Arrendamientos, in which Wells Fargo Bank (US) has a share of about 20%; Arrendadora Comermex of the Comermex group; Arrendadora del Atlantico; Arrendadora Banamex, owned 40% by Citibank (US); Arrendadora Internacional SA, with Bank of Boston (US) as a minority partner; Arrendadora Bancomer, owned 49% by Manufacturers Hanover Leasing Corp (US); and Arrendadora e Inversionista Latina SA, partly owned by First National Bank of Chicago (US).

11.04 Stock and bond financing. In early 1986, the National Securities Commission (CNV) reinstated a previous ruling against majority foreign-owned companies issuing bonds. However, in early 1987, CVN official indicated they are once again willing to consider requests by majority foreign-owned firms to make such issues. Approval will be more likely to be granted in the second half of the year when local market conditions are expected to improve. The type of project to be financed by the issue has some bearing on the approval process.

In 1986, total emissions reached P535.1 billion—a real increase of 134.5%. There were 37 new offerings, for a total of P135.9 billion, an increase of 123% over 1985. In 1985, multinational companies, such as Ford, Chrysler and Nabisco, were among the 24 firms issuing bonds. Chrysler worked hard to secure CNV approval, which was growing increasingly difficult at the time. The funds were to be used to finance a large-scale plant improvement. The company apparently won CNV approval because of its ambitious export program and the positive employment effects of the investment.

Typical maturities that the CNV will approve are terms of four to seven years. It requires voluminous documentation before approval and stipulates that funds must be used for fixed assets only. Regulations issued in 1984 now allow firms whose shares are not publicly traded to issue corporate debentures through the stock market. The CNV charges a 3% fee. Coupons have a floating-rate structure, typically linked to Cetes or bank deposits (whichever are higher). The seven-year P800 million issue by Nalcomex in June 1986 was set at Cetes or CD yields plus five percentage points.

Mexico has a single stock exchange, known as the *Bolsa de Valores*. There are 187 stocks registered on the bolsa. Of that amount, 112 are industrial companies. Only about 26 stocks are highly liquid and can be easily traded; another 23 have some liquidity, but rapid purchase and sale can be a problem. As a result, Mexico's stock market is extremely thin. Adding to the problem is that listed companies seldom allow more than 7% of their stock to be freely traded. In 1986, four companies alone—Frisco, Kimberly Clarke de Mexico, Grupo Pliana and Vitro accounted for 13.4% of the total volume traded. Stock trading still accounts for only 4.9% of total *bolsa* activity.

Despite the economic downturn, the bolsa has been rising steadily since 1985. In 1986, it posted the second highest gain in the world—up 215% in real terms. By mid-February 1987 alone the Bolsa was up 40.8% in nominal terms and had hit a record 65,981 points on the index. The narrowness of the market makes the bolsa a poor indicator of overall economic performance, however. Speculative moves against several stocks or government invervention (support of various stocks by Nafinsa for instance) can cause jumps in the index.

In early 1987, the market appeared to be enjoying the effects of expectations that Mexico will experience traditional growth during the presidential election period. Some investors are also investing in companies that are expected to undergo debt capitalization, which tends to push up their stock prices. The high real returns paid by stock investments in 1986 have also no doubt attracted some new investors into the market.

The availability of tax incentives (capital gains are tax exempt for individuals) and the strengthening of local brokerage houses have also played a role in putting life into the long dormant market. The bank nationalization has had the effect of drawing creative ex-bankers into the brokerage business, an area they largely ignored when they were running the private banks prior to 1982.

Stock mutual funds have also begun to play a larger role. In 1986, 60.9% of the stock traded was in industrial, commercial and service companies, while trading in mutual funds accounted for 36.5% of activity.

New stock issues have begun to pick up after four years of no activity. In 1985, one company, Nacional de Drogas, issued P908 million worth of shares, representing 25% of its total stock. In 1986, there were 19 new issues. Eight issues were money market mutual fund companies, and six were stock mutual funds; three were *casas de bolsas*. A telecommunications firm, an insurance firm and a bonding firm also issued stock. Tele Industrias Ericsson SA issued P6.5 billion worth of shares as part of a Mexicanization move to reduce its foreign ownership from 90% to 80%.

Other new issues were Val SBM, P200 million; Valores Awlasa, P500 million; Afin, Soc. Inv. Renta Fija, P5 billion; Invermexico, P1.5 billion; Madrazo, Money Market Fund, P500 million; Operadora de Bolsa, P3 billion; Fondo de Inversion Fova, P500 million; Fondo de Acciones Finamex, P5 billion; Fondo de Renta Fija Bancomer, P10 billion; Fondo Valbrumer, P1 billion; Fondo Valmer de Capitales, P968 million; Fondo Mexinval, P1 billion; Probursa, P2.2 billion; Multifondo de Renta Variable, P2 billion; Bursamas, P300 million.

In a potentially important development that could help strengthen Mexico's weak local capital market, several changes were made in regulations governing Mexico's nascent venture capital funds. In January 1987, regulations were published allowing venture capital funds to own up to 100% of the firm in which they invest, providing greater potential control for the investing fund. Foreign companies were allowed to own up to 49% of a venture capital fund operating company, and the law leaves open the possibility for majority ownership if approved by the FIC and the Treasury Secretariat. The changes have encouraged foreign banks and *casas de bolsas* to begin talking about joint ventures. The initial foreign investment will likely be made using debt swaps. Citibank, Morgan Guaranty, Bankers Trust and Chicago First National and Paine Webber are said to be discussing investment possibilities. If the joint ventures come about, the participation of foreign venture capitalists and their ability to control 100% of the funds could provide the security and confidence necessary to attract offshore investment into the Mexican financial market and substantially strengthen it.

12.00 LABOR

12.01 General. Most firms find labor plentiful and relatively cheap. In some geographical regions, lack of industrial maturity can be a problem—often much of the work force is composed of first-generation factory workers, to the detriment of productivity. Many companies feel their principal operating problem is the serious shortage of skilled labor and managerial personnel. Though companies experience a shortage in well-trained middle and upper management, the most serious labor problem now is more immediate: how to maximize job retention and minimize employees' loss of purchasing power.

Labor-training legislation introduced in 1978 has improved the situation somewhat by increasing the pool of skilled labor. The law formally obligates companies to set up training programs for all workers; however, the requirements remain fairly hazy. In essence, it calls for training at all levels, from top management down to the least skilled worker, and aims for quick promotions. Training is to be conducted on company time, unless it is not directly related to a worker's job (e.g. language lessons), and may be in-house or in conjunction with registered instructors or institutions. Excessive red tape has stymied the program's implementation.

Programs and related policy matters are decided by a mixed commission comprising an equal number of worker and company representatives at each firm and usually including skilled workers, supervisors, the plant manager, the industrial-relations manager, etc. The training program must be registered with the Coordinating Unit for Employment and Training (UCECA), which authorizes the program after consulting with national level committees composed of industrial workers and technical experts.

The cost of the training programs is tax-deductible. The labor secretariat has begun to enforce the training provisions by using Social Security Institute (IMSS) company lists and cross checking for registered training programs.

Several executive-recruiting services are available for companies seeking to contact top managers. Recruitment of skilled labor is normally done through unions, newspaper advertisements, employment agencies, industrial chambers and groups such as the American Chamber of Commerce of Mexico, which offers a placement service. Unskilled labor is usually recruited at the factory gate, through unions or by word of mouth.

Absenteeism has generally declined owing to job-security fears. However, while fewer workers fail to show up, lack of punctuality still affects productivity. A study by the Mexican Association of Finance Executives found that Mexican workers miss an average of 12.5 working days a year.

12.02 Unions and work stoppages. About half of Mexico's work force is unionized, and unions represent about 90% of industrial workers in establishments of more than 25 workers. Most of these workers belong to one of the nine big national labor federations. Unions have firm control over their members. Only about 15% of union workers belong to single-company unions; the rest are members of nationwide organizations. Firms sometimes face considerable jurisdictional strife, as each union seeks to get the best working conditions and highest salaries. Federal law requires that collective-bargaining agreements be renewed at least every two years. Salaries must be reviewed annually, though for the past two years there has also been a midyear minimum-wage hike. Many firms have granted these midyear salary increases to workers that fall under collective contracts as well.

The oldest labor organization is the Confederacion Regional Obrera de Mexico (CROM), with over 400,000 members from the textile, shoe, garment and maritime industries. But the strongest union organization is the Confederacion de Trabajadores de Mexico (CTM), representing three to four million members, about half of Mexico's organized work force. The CTM is a mainstay of the Partido Revolucionario Institucional and is closely connected with the government.

Labor's political organization is the Congreso del Trabajo (CT), which includes the CTM, the CROM and the Confederacion Revolucionaria Obrera y Campesina (CROC). The CROC represents about 700,000 members and is chiefly made up of unions in the textile, restaurant and shoe industries. All together, CT-affiliated unions represent about 90% of the organized labor force.

Strikes are legal only if employers have refused to comply with their contractual obligations (e.g. to make or revise a contract; to accept an arbitration award by a board representing the workers, management and the government; or to pay legally required profitsharing). A strike may also be called to support another strike if the majority of workers agree. Labor's stance has been moderate over the past four years—in 1986, there were 189 strikes called out of 13,969 labor disputes. The number of disputes has been declining each year, and the level in 1986 was only 23% of the 1983 level—partly because of job-security concerns and a strong government hand in preventing strikes. Any uptick in the Mexican economy, on the other hand, will likely make labor more aggressive.

In 1987, the government's moves to declare an electrical workers strike illegal and its successful moves to isolate the telephone workers in their strike has strained government-labor relations. The upcoming presidential elections and labor's crucial role in getting out the vote argues for the government to be more indulgent in coming months. Labor has begun to increase pressure for formal wage indexation, and if inflation continues in the three-digits' range in the next administration, such a move could be passed by Congress.

12.03 Wages. Minimum wages are set by the National Minimum Wage Commission, a tripartite group comprising representatives of business, labor and government. The commission has moved toward a more uniform national minimum wage, and in 1986 a three-tiered scale replaced the former four levels. In 1986, wages were hiked an average 32% in January, 25% at midyear and 20.1% in October, for a compounded 98.4% increase for the year against 105.7% inflation. So far in 1987, the minimum wage was increased 23% in January and 20% in April. The government's stated objective is to maintain real wages at the 1986 level.

With the April increase, Mexico's minimum wages stand at P3,660 per day: P3,660 for Mexico City and certain border cities; P3,385 for Monterrey, Guadalajara and other cities; and P3,045 for the rest of the country. Actual wages in industry are much higher than the legal minimums, and even these are subject to an additional premium of about 50–60% for legally required fringe benefits.

12.04 Working hours. The normal workday has traditionally been eight hours, and the normal week, 48 hours. For every six-day work period, the worker is entitled to one day of rest with full pay. Overtime is paid at twice the normal rate for the first nine hours a week and triple pay thereafter. Workers receive a 25% premium for Sunday work.

In the past several years, unions have applied intense pressure to obtain a 40-hour week for all industries. Employers have generally resisted because they fear lower productivity. However, most industries that have not already adopted the shorter week are expected to do so eventually, and the government has left the matter to be decided in collective bargaining.

12.05 Fringe benefits. The overall cost of fringe benefits is substantial at present, and demand for additional benefits will become more pronounced in the coming year. Fringe benefits and profitsharing currently add about 60% to base payroll expenses, depending on the salary level of the employee. The most important benefit is profitsharing: All firms must distribute 10% of their pretax profits to employees.

The labor law grants seven paid holidays annually plus one for Inauguration Day every sixth year. Labor contracts call for another nine to 10 paid holidays. After a year's work, employees are entitled to at least six days' paid vacation, increased by two days for each additional year of employment, up to a total of 12 days. But, as a rule, employers grant 15 days under their contracts, and some pay an additional 15-day vacation bonus. (A bonus of 25% of normal pay during the vacation period is mandatory.) A Christmas bonus of 15 days' pay is also obligatory and must be paid before December 20. Sick pay is included in only a few contracts since Social Security provides compensation. Where it is included, it can run to 90 days at full pay and 45 more at half pay. Companies must also contribute a sum equal to 5% of payroll to a national workers' housing institute (Infonavit) established in 1972.

The social security system, administered by the Social Security Institute, provides many other benefits. Its programs cover work-connected accidents and illnesses (e.g. 100% salary for up to 72 weeks of disability and permanent disability insurance); non-occupational diseases and paid maternity leave; daytime nurseries; disability, old age and various death benefits; and unemployment insurance. The cost of social security is shared among employers (62.5%), employees (25%) and the government (12.5%). The employer's share may run to about 10% of payroll.

In addition, companies with more than 100 employees must maintain a fully equipped infirmary under the direction of a qualified doctor, and firms with more than 300 employees are required to establish hospital facilities. A 1986 Supreme Court decision found, however, that firms are relieved from this responsibility if they are affiliated with the Social Security Institute. The mandatory worker-training program (12.01) has also added to employer costs.

Besides the mandatory fringe benefits, most labor contracts provide for such "voluntary" benefits as savings plans, life insurance, social and sports activities and lunches. Most large companies maintain a cafeteria on the premises, serving meals well below cost to their employees. Many companies supply working clothes, make interest-free loans and help finance automobiles. Some employers set up additional incentive plans to stimulate increased production and sales. In general, fringe benefits are tax deductible if they are provided to all employees.

12.06 Dismissal. Unless dismissed for a justifiable cause (i.e. dishonesty, disrespect, absenteeism, etc.), laid-off employees are entitled to three months' pay and 20 days' additional pay for every year employed. Workers employed over 12 years receive an additional 12 days for every year of service after the twelfth. A ceiling on this calculation has recently been established, however, and it is twice the minimum wage at the time of calculation multiplied by 12 days and the number of years. If the employee decides to appeal the dismissal, he receives full pay from his last day of work until the court reaches a final decision.

Workers unjustifiably dismissed are allowed to choose between reinstatement and indemnification of three months severance pay. Employers can refuse to reinstate confidential employees, apprentices and workers with less than one year's service, but must add 20 days' pay for each year of service to the standard three months' severance pay, or pay half the time worked if it was less than a year.

12.07 Limitations on foreign nationals. According to Sec. I of the federal labor law, at least 90% of a firm's skilled and unskilled workers must be Mexican nationals. Sec. III of the same law requires that employers favor Mexicans over foreigners and unionized personnel over nonunionized employees. A special provision permits temporary employment of foreign technicians (up to 10%) if firms can prove that skilled workers are not available locally. The 10% limit does not apply to managers, directors and other key officers, who must secure special immigration permits. In addition, operations along the US border are exempt from the personnel requirements (13.05). Some foreign firms strongly feel the pressure for Mexicanization in the personnel area, and application of the regulations gets stricter every year. The 1973 law regulating foreign investment places special emphasis on the Mexicanization of management.

Foreigners may enter Mexico with either nonimmigrant (*visitante*) or immigrant (*inmigrante*) status. *Visitante* status allows them to work for a six-month period and can usually be renewed once for another six months, or twice in certain circumstances. Foreigners may enter as immigrants for a five-year period, during which time they may not spend (either continually or intermittently) more than 90 days outside the country during the first two years, or 18 months or more over the five-year period. Otherwise, foreigners lose their status as immigrants (unless special permission is granted by the Secretariat of the Interior). After five years, foreigners must apply for permanent immigrant (*inmigrado*) status if they want to remain in the country. Recently, the Interior Department has become very strict about not granting *inmigrado* status to foreigners who aren't married to Mexican nationals.

Mexico has various categories of immigrants, but three are of special interest to the foreign investor. *Cargos de confianza* status may be obtained by foreigners who fill key executive posts or other positions of responsibility in established corporations or institutions. The Secretariat of the Interior will grant such status only if it is satisfied that the work is necessary and no local national is able to do it. Firms should apply for this status well in advance, since the process takes several months. Occasionally, a foreigner can qualify for initial nonimmigrant status, which is later changed to immigrant status if the holder goes abroad and reenters the country.

Inversionista or investor status may be obtained by foreigners who invest in industrial activities that contribute to the economic and social development of the country. *Tecnico* or technician status may be granted to people who undertake research, technical or other specialized activities for which no qualified residents are available. Mexico also has provisions for scientists, professionals, people with independent income, dependents of immigrants and permanent immigrants.

To obtain immigrant status for its employees, a company must file applications with the Secretariat of the Interior in Mexico, submitting evidence of investment (with proof of tax payment). Usually, a new company may not apply for permanent residence visas for its personnel unless the government considers its activity of importance to the nation, and until it has been operating for two years. If approved, the permit is granted provisionally for five years and reviewed every year. At the end of the five years, foreigners are eligible to become *inmigrados*, or permanent residents.

13.00 FOREIGN TRADE

13.01 General. In 1986, oil and oil-related products accounted for only 35% of Mexico's export revenues as a result of the dramatic 57% decline in petroleum exports. Nonpetroleum exports witnessed a 41% growth owing to rapid devaluation of the peso and access to export financing. Petroleum exports should recover somewhat in 1987, rising to $7.7 billion, vs $5.6 billion in 1986. Average prices for Mexico's oil should be at least $14.5/bbl (vs $11.87/bbl in 1986).

The administration is making a serious effort to expand nonoil exports, which are considered vital to obtaining foreign exchange and utilizing idle capacity. Improvements in the Profiex export promotion program announced in March 1986 now treat exporter suppliers as exporters entitled to most of the same benefits. Yet, despite their dramatic rise in 1986, nonpetroleum exports could fall off in 1987 and 1988 as the domestic economy comes out of its slump. Exchange rate policy and US-Mexico trade relations will remain salient factors as well.

The rapid 148% devaluation of the controlled rate in 1986 spurred the 41% grow in nonpetroleum exports, which totaled $9.7 billion. The rapid devaluation also held down imports, despite Mexico's trade opening. Imports fell 14%, to $11.4 billion. The trade balance fell from $8.45 billion in 1986 to $4.6 billion in 1987 as a result of the loss of $8.46 billion in petroleum revenue.

While Mexico has been striving to diversify its exports and imports in order to lessen its dependence on the US, progress has been meager so far. The US remains its chief trading partner. In 1986, exports to and imports from Mexico's northern neighbor accounted for 63% and 68%, respectively, of its total trade.

Besides the US, Mexico's leading trading partners are Japan, Canada, Europe and other Latin American nations. In 1986, Japan took 7% of Mexico's exports and provided 6% of its imports; the respective figures are 7% and 1.7% for Spain, 4.5% and 1.7% for the UK, and 3% and 2.8% for France. Next in line were Brazil, Israel, West Germany and Canada.

Export licenses have been lifted from most products and now exist for approximately 12% of total exports, mostly foodstuffs, precious metals and some raw materials. Revenues from export sales must be converted at the controlled exchange rate (1.04, 7.01).

13.02 Import controls. Since 1983, Mexico has been gradually dismantling its system of heavy protection through import permits and reference prices. Mexico's entry into GATT in September 1986 will push the process further along.

Currently, 638 items out of a total list of 8,077 imported products still require licenses. Mexico wants to retain licenses on about 600 items, but has yet to formally justify them to GATT. This list naturally includes many key imports: basic agricultural products; many manufacturing inputs, such as automotive assembly parts; raw materials for the pharmaceuticals industry; final products for the computer industry; and some machines and tools, including those related to transport of materials and to the paper industry. About one third of the products still requiring licenses are considered luxury goods whose import is only allowed in exchange for a greater volume of exports.

During 1986, Mexico eliminated reference prices on all but 960 products. In June 1987, Mexico will eliminate reference prices from another 238 items. Mexico has also lowered its tariffs, with the range now 0 to 45%. Three quarters of all products are now in the 10% range.

To compensate for the removal of reference prices, Mexico has put high tariffs on the affected products. It has also passed antidumping legislation. Cases began to be processed in September 1986. Action can be swift. Products can be hit with countervailing duties if local producers can show damage and if the imported good in question is being sold locally at a price below that in the country of origin. Secofi can make a preliminary ruling within 10 days. Exporters are not notified until the preliminary finding is published in the Official Gazette. Input from the exporter is allowed during the six-month period leading up to the final ruling. Currently, there is no formal appeal procedure following the Secofi ruling, but once Mexico signs the GATT code on antidumping—something it has promised to do—an appeal procedure will have to be implemented.

Authorities have consolidated into a single document the 30 import and export license forms that previously stymied companies. They have also reduced the red tape required to register persons entitled to handle such transactions.

The allotment for goods subject to quotas was hiked to $1.75 billion in 1987, from $300 million the previous year, and now covers an estimated 12% of purchases abroad. Not all of the increase is liberalization, since some products, such as aluminum, tinplate and inputs for the paper industry, are now subject to quotas.

Although most imports into the free zones are excluded from the licensing rules, several goods—mainly locally manufactured metal-mechanic components, packaging material and some chemical substances—now need an import license. Temporary imports that are used to manufacture exports are exempt from import license requirements, and regulations have been liberalized.

13.03 Tariffs and import taxes. Duties range from 0% to 45%, with higher duties for greater value added and for goods already produced nationally. Duties were structured generally as follows: 0% for agricultural inputs such as fertilizers and seeds; 5% for unassembled machinery and equipment; 10% for raw materials and capital goods not manufactured in Mexico; 15% for intermediate goods that are part of a long production chain; 20% to 30% for goods for which approximate substitutes are manufactured in Mexico; 40% for goods in the last stage of the production chain and intermediate agricultural goods; and 45% for nonpriority finished goods.

Starting in 1982, exemptions previously granted to fellow LAIA members were waived in some cases; in others, a margin of preference was conserved, but duties were hiked considerably. Last year, Mexico reinstated the system of preferential tariffs on imports from other LAIA members. Mexico also applied unilateral duty preferences for goods imported from the less-developed Latin nations. In addition to duties, a 2.5% tax is levied on all imports, which are also subject to the 15% VAT.

Automotive manufacturers, companies in priority industries and producers of specific chemicals and capital goods are eligible for import duty exemptions (10.06). Authorities will maintain the use of import duties to protect local industry and promote import substitution.

Importers may declare imported goods at the port of entry or transport them to interior customs houses in cities such as Mexico City and Guadalajara for clearance. Goods may be stored in bonded warehouses for one year, extendable to a second year, during which time the firm may withdraw the merchandise in whole or in part, provided withdrawals are of whole packages or in portions of at least one metric ton. Duties are paid on withdrawal.

13.04 Nontariff barriers. Mexico has no major barriers apart from import-licensing procedures (a situation that is now changing—see 13.02) and exchange controls (7.00). However, imports of luxury cars and vans are prohibited. Full customs duties on imported motor vehicles must be deposited in advance. Import quotas were in force for about $1.75 billion worth of imports throughout 1985, representing 12.5% of that year's estimated purchases abroad. These imports include raw materials for the pharmaceuticals and paper industries, photographic paper, aluminum, wool, sodium carbonate, herbicide, butyric fats, kraft paper, natural rubber latex, tin plates, cattle hides and computer components.

All branded patent medicines, toilet accessories, foodstuffs and drinks must be registered with the Department of Health, and all electrical equipment must meet Mexican safety rules.

13.05 Free ports, zones. Mexico's free ports have all been eliminated and turned into free zones. Thus, the free ports of Coatzacoalcos (Veracruz) and Salina Cruz (Oaxaca) are classified as free zones. Several other port cities have free zone areas: They include Ensenada (Baja California Norte), Guaymas (Sonora), Mazatlan (Sinaloa), Lazaro-Cardenas (Michoacan), Progreso (Yucatan). The most important free zones are the states of Baja California Norte and Sur, Quintana, North-West Sonora and Agua-Prieta (Sonora).

Companies importing goods or materials into a free zone for completion and sale to the domestic market are eligible for a partial duty exemption on those items. The size of the exemption is determined by the difference between the levy on the material actually imported and the amount that would have been paid had the item been imported in finished form. A manufacturer simply has to prove that the additional fabrication took place in the free zone. Authorities promise to expedite applications within 30 days. Moreover, companies are permitted to post a bond for the expected waiver rather than pay the full amount and receive a refund at a later date.

Free zones are used all over Mexico to stimulate assembly industries. Plants may be set up virtually anywhere in the country (except where industrial concentration is dense) as "in-bond" assembly plants (*maquiladoras*) without regard to Mexicanization requirements and immigration limits. Procedures to set up an in-bond company are quite simple (see the box on p. 35), and the whole process generally does not take more than three months. It is recommended to use a law firm with ample experience in assisting firms to establish a *maquila* plant.

Because of US quota restrictions, certain textile and apparel *maquiladoras* must be at least 51% Mexican-owned. *Maquiladoras* may not own land along the borders for operations. They may lease land or use the *fideicomiso* system, through which a local bank holds the land in trust for the user (3.06). Most firms simply rent space in the border zone's many industrial parks.

Real estate to establish an in-bond production facility may be freely bought in the interior of the republic. Foreign technical or management personnel are easily granted work visas. For tax purposes, it is advisable that a technical and management assistance agreement be executed between the *maquiladora* and its parent. Such an agreement must be registered with the national transfer of technology register. This regulation is generally easy to obtain for in-bond companies.

The extension of the in-bond assembly scheme from border areas to almost anywhere in Mexico was chiefly aimed at boosting employment. Under the scheme, foreign-owned firms may import machinery and raw materials duty-free and ship the goods from the assembly plants. When the US is the target market, as it is in most cases, the goods are subject to duty only on value added under Secs. 806 and 807 of the US tariff code. A 1983 decree for the in-bond industry allows *maquiladora* manufacturers to apply for permission to sell a set percentage of their output (20% is the stated limit, but this can be negotiated upward) to the local market (even more when a plant is located in an undeveloped zone), provided local production of these goods is insufficient and no special program to develop similar industries exists. Local content and balance-of-payment requirements must also be met.

The number of in-bond companies grew from 790 to 925 in 1986, an increase of 17%. Rapid devaluation of the peso cut into value-added growth, however. Value climbed a mere 1%, to $1.29 billion. Job expansion continued to be strong. Employment increased by 50,000, to 268,000. Value added should reach $1.5 billion, and employment 300,000 in 1987.

The majority of *maquiladoras* are partly or wholly US-owned or US-licensed. Clothing, auto parts and electronics plants are the most common. Parts are shipped there from the US for assembly by local labor, and the finished product is then shipped back to the US, subject to US duties only on the value added in Mexico. Since in-bond incentives were extended beyond border areas, in-bond plants have been set up in Chihuahua, Torreon, Guadalajara and other interior sites. Japan, Korea and Taiwan are also showing an interest in *maquiladoras* as assembly sites for products sold into the US market.

To attract a wider range of Mexican-controlled manufacturing enterprises to the free zones, 100% freedom from import duties on machinery, equipment, spare parts and raw materials is available to companies that are at least 51% Mexican-owned and setting up export, assembly or repair operations, and to firms engaged in agriculture, forestry, fishing or mining production or processing. The plan differs from the existing in-bond arrangement in that companies are not obliged to export all of their production; however, they must have a favorable balance-of-payments impact and provide import substitutes. These companies may also sell their products on the domestic market if they achieve local content equal to the average industrial level (outside the free zones).

13.06 Export incentives. The de la Madrid administration backed its commitment to export promotion with some substantive incentives when it unveiled its Profiex (Integrated Export Development Program) export-development program in 1985. Profiex was designed to help Mexico compete interna-

Requirements for Setting Up an In-Bond Facility in Mexico

A. Any Mexican national or any corporation which has been organized according to Mexican law, for example as a *Sociedad Anonima*, may request authorization from the Secretariat of Commerce and Industrial Development (Secofi) to operate under *maquiladora* status in Mexico. Companies that participate in the Mexican market must request authorization in order to use part of their idle production capacity for *maquila* purposes.

B. If a company has foreign capital, it must request and obtain an authorization to incorporate from the Secretariat of Foreign Relations. (This is separate from the procedure detailed below involving the Commerce Secretariat.) Foreign Relations will request the following information: proposed name or names of the company in Mexico, capital stock, domicile, duration and the final draft of what are to be the purposes of the company (in this case, to operate a *maquiladora*). Companies with foreign capital also must register with the Secretariat of the Interior (Gobernacion) and the National Foreign Investment Registry.

C. All companies that want to operate under *maquiladora* status must file an application with Secofi at the Direccion General de Promocion Industrial y Desarollo Regional, Subdireccion de la Industria Maquiladora, Periferico, Sur 3025 (Tel: 595-37-10). The application must include the following:

(1) General information of the company: Name and domicile, amount and structure of capital stock, date of incorporation of the company, federal taxpayers register, foreign investment register, date of the legal representative or authorized as of the last board of directors meeting, main officers of the company, names of foreign or Mexican suppliers;

(2) Description of the production process: For the first two semesters, the value must be stated for use of domestic and foreign raw materials and packaging materials, amount of national added value generated in the country, creation of jobs for workers, technicians and administrative personnel, duration of the production cycle.

(3) General characteristics of the product or service: Name and use of the product, technology transfer, countries to which the product will be exported. Textile companies should include the following information by product: textile category (US), type of weave, use and amounts of the fabric in sq yds and kilograms.

(4) A list of the raw materials to be imported temporarily, per semester (for two semesters, amount and value).

(5) A list of the machinery and equipment to be used in the *maquiladora* operation (technical description, value, production capacity, new or secondhand, origin).

(6) Investment program: building and facilities, total fixed investment, working capital.

(7) Any additional information Secofi may require. Depending on the specific assembly/production operations of the *maquiladora*, additional permits—such as from the Secretariat of Health—may be required.

D. Before Secofi issues its final approval, the company must commit to the following requirements:

(1) Compliance with the *maquiladora* program, which is approved with regard to the amount to be invested in Mexico, value to be added to the product, the number of jobs to be created and location of the plant.

(2) Use of the equipment and/or raw materials which are imported under the in-bond status only for the purpose for which the company has been authorized.

(3) Hiring and training of Mexican personnel according to the law.

(4) Compliance with all tax, labor and foreign exchange control regulations.

(5) Notification to Secofi of any changes in the operation or of any suspension of activities at least 10 days in advance.

E. Once Secofi approves the program, the company receives a number in the National Maquiladora Industry Register (Registro Nacional de la Industria Maquiladora); this number must be used by the company in all subsequent official communication. All companies must request renewal of the registration every two years and Secofi may then review whether the company has complied with its commitments.

F. After approval, Secofi will also notify the Customs Department of the Secretariat of the Treasury (Hacienda). The Customs Department (Direccion General de Aduanas) will then open a file in which all imports and exports of the company are to be recorded. The department will also register which items are to be imported, the period during which they are to remain in the country, the port of entry of imports and exports and the authorized percentages of shrinkage and wastage.

G. *Maquiladoras* must post a bond for an amount equal to the duties that would have been paid on definitive imports. Once the company has established its solvency in the eyes of the Customs Department, this department may authorize that the bond to be posted cover only 40% of the duties that would have been paid on definitive raw material imports, and 60% of the duties that would have been paid on definitive imports of machinery and equipment.

H. After the company receives Secofi approval for its *maquila* program it must start to import all authorized items within six months following the approval. The firm may obtain a Secofi extension in special circumstances, such as the construction of special installations.

I. Companies must start exports within the six-month period following the date of raw material imports. All raw material and supplies imported must eventually be discharged through the corresponding exports of imported items. There are special provisions for shrinkage, wastage and rejects.

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tionally without running afoul of antisubsidy agreements. Incentives included a more generous import-duty rebate (drawback) system; more liberal tax breaks for export-related expenses; cash refunds of the value-added tax; expansion of the temporary import program; and increased benefits for trading companies in the in-bond industry.

In June 1985, the government announced another component of its export-promotion effort—the Dimex free-import scheme. Dimex enabled exporters and their suppliers to import, without license or authorization, goods for the local or export market. Limits were set according to companies' overall exports. Dimex applied only to exporters whose goods had at least 30% local content.

The program lost much of its punch when in July 1985 the government lifted import licenses for 3,604 items overnight. Currently, about 638 items still require a license.

In March 1986, the government acknowledged that Profiex had fallen short of its goals and announced a series of measures to support the program. These include the following:

- Suppliers of exporters are promised the same benefits as exporters with respect to taxes, duties and financing. Suppliers will have access to government resources for both peso and hard-currency financing.
- Exporters of manufactured goods no longer need approval to bring in temporary imports for export production. Like the in-bond industry, they now only have to register their anticipated temporary imports with Secofi. Officials have also promised lower bonds on temporary imports, which currently range from 40% to 60%. In addition, duties on goods made from temporary inputs that have been authorized for sale in the domestic market will be levied only on the imported component—and not on the final product.
- Officials promise to extend rebates of indirect taxes on production, in addition to the refund of the VAT already extended to exporters. Trading companies have also been promised similar fiscal incentives, as well as preferential credits.
- Exporters (and, if they wish, their suppliers or affiliated companies) may now use up to 100% of their export earnings to

prepay imports. Proceeds can be kept in special interest-bearing accounts and used, without prior approval, for any transaction eligible for the controlled exchange rate.

- Officials promise to provide exporters with "sufficient and competitive credits"—presumably at permissibly attractive rates. Mexico's trade bank Bancomext granted P3.2 trillion worth of peso and dollar credit in 1986 and is expected to make P6.7 trillion available in 1987.

13.07 Export insurance. Export-credit insurance covering political risk may be contracted from Fomex for up to 90% of export value. Later this year, a single policy covering political and commercial insurance risk is expected to be available through Comesec, though Fomex will still cover the political risk portion of the policy. Premiums vary according to contract term and export destination. One year of insurance covering exports to the US carries a premium ranging from 0.125% to 0.9%, while a similar contract for sales to Central and South America may cost up to 1.5%. These rates reportedly are being examined, however, and may increase. Commercial export insurance is available through Comesec, which has paid-in capital of P100 million and a reserve for damages of P2.269 billion. Rates are based on the company seeking the coverage and the destination as well as the time period to be covered. Ninety-day coverage to the US currently costs 0.7%; 180-day coverage costs 0.9%. Rates for Third World shipments are 1.4% for 90 days and 1.9% for 180 days. Rates can go as high as 2.5% for unknown companies shipping to the Third World. Coverage ranges from 70–80% of shipment value. Global and specific shipment policies are available.

The government requires export-credit insurance for all companies that use the concessionary credit extended by Fomex.

13.08 Export credit for financing sales is available in ample volume for industrial products with a minimum of 50% Mexican content. Exporters obtain the credits through their commercial banks or from state institutions, which discount them with Mexico's export development bank, Fomex. Fomex offers export as well as preexport financing. In the latter program, majority Mexican-owned companies manufacturing goods with over 50% local content can obtain financing of 100% of their direct production cost—or 70% of the f.o.b. price; 85% of the f.o.b. price if the firm is enrolled in a Secofi-registered export program.

Companies producing items with a local content between 30% and 50% may receive preexport financing for 100% of the Mexican part of their direct production cost or double that amount if the company has a Secofi-registered export program. The terms of these loans run from the time raw materials are purchased until the final export. (The rate presently stands at around 95% of CPP.)

Fomex will finance 100% of the invoice value plus interest for exports with more than 50% local content if the term is one year as of the date of shipment. For one- to two-year terms, companies can finance 85% of the invoice value, and Fomex will provide funds for 85% of the cost of the Mexican part of the invoice, and 85% of the imported part of the invoice if they agree on a two- to five-year term. If credit terms exceed five years, Fomex sets the amount it will finance on a case-by-case basis.

Firms that export products with 30–50% local content can apply for 100% financing of the Mexican part of the invoice for terms up to one year, and 85% of the cost of Mexican parts for terms that run from one to five years. Here again, Fomex will set the amount if the term is over five years. Export credits up to two years carry an interest rate equivalent to the rate of US bankers acceptances plus one (currently 6.75%) on six-month operations. Interest must be paid in advance for credits up to 360 days; in other cases, interest is charged on a quarterly basis.

Rates on medium- and long-term export credits depend on the destination of these exports: Rates for goods sent to developed countries range from 9.55% p.a. for two- to five-year terms to 9.8% p.a. for five- to eight-and-a-half-year terms. To countries with an intermediary level of development, the charge is 8.25% p.a. on two- to five-year export credits and 8.75% p.a. for five- to eight-and-a-half-year credits.

Medium- and long-term credits for exports to developing countries carry an interest rate of 7.4%. Bancomext, through Fomex, makes credit available for nontraditional agricultural exports; the export bank took over this function from the central bank. The central bank finances 100% of the total invoice for a 90-day term at a rate equivalent to 50% of LIBOR plus two percentage points; 180-day financing for these exports is also available at 75% of LIBOR plus two percentage points. Companies can apply for this credit through their regular commercial bank or through Bancomext.

Bancomext also makes financing available to foreign companies that import Mexican goods with at least 30% local content. These goods must be considered nontraditional exports going to nontraditional export markets, and they must generate net foreign exchange earnings of 30% of the shipment's value. Rates and terms are the same as those given by Bancomext to Mexican exporters.

When credit is sought before production starts, the prospective exporter must support its application with copies showing a firm order and a commitment to produce, as well as a description of the manufacturing process, giving the time required until the shipment is ready. When financing for 70% or more of the sale price is sought, a detailed and certified cost analysis must be submitted. Exporters' experiences with such arrangements have been favorable, especially since they are obtained through their regular banks, minimizing red tape.

Although not widely publicized, individual bank financing for exports is also available, and rates are set according to the bank-client relationship. One major exporter of chemical products was able to obtain a dollar-denominated loan paid out in pesos at the controlled rate. The dollar rate was 7%. To this cost the controlled rate's devaluation must be added. The company must show its export invoices in order to guarantee export revenues. With the expected hike in interest for export credit, the rate of these dollar-denominated loans will also be raised to international market rates.

Banks offer short- and medium-term export and import credits at about the same rates as regular commercial loans. As with all commercial bank credit, availability is limited. (Long-term export and import credit is only available through Somex.)

A credit facility supplying $100 million was made available to

Mexico's private sector to finance large imports of machinery, equipment and spare parts required for the production of exports and for import substitutions. The facility is provided by the International Finance Corp, Morgan Guaranty Trust and the Bank of America. Each loan from the facility is guaranteed by Bancomer and Banamex. Companies may apply through any of these four banks; they will jointly identify prime borrowers. Credits range from $5 million to $6 million, with a maximum maturity of eight years. Interest rates are payable on a quarterly basis and fluctuate from 1.5% to 2.5% over LIBOR, depending on the term, amount and the client's credit standing.

Fomex also provides exporters with foreign currency financing needed for imports. Through its Profide program, credits are granted directly to the foreign supplier—up to 100% of the import value. Officially, maximum credit is $15 million, or 60% of the firm's total annual export plan, although exceptions have been made to allow larger credits. Cost is two points over the six-month bankers acceptance rate in New York, and the term is from the time raw materials are imported up to the point at which the finished product has been paid for.

Bancomext has opened $2 billion worth of foreign currency credit lines to finance raw materials, spare parts and machinery imports. In general, up to 85% of imports can be financed through these credits, although funding may be up to 100% in some cases. Companies must be found creditworthy by Bancomext, or any commercial bank, and must also be located in Mexico (no minimum Mexican ownership is set). Imports must be used in priority activities. Minimum financing, if required, depends on the country with which the credit line is arranged. Terms depend on the goods imported and fluctuate between 30 days and one year for raw materials and up to eight and a half years for capital goods. Interest rates are often fixed and may range from as low as 5% to 10.5%, depending on the term and imported good.

Bancomext also manages a trade line with Brazil that provides a revolving credit of $150 million in each direction. Brazilian imports with at least 30% local content—calculated on a direct cost basis—can be financed through this credit system for a minimum amount of $1,500. Maturities range from two years to eight years, depending on the goods imported. The interest rate is set at 7.5% p.a.—except for loans to import steel products, for which 9% is charged. Up to 85% of the purchase price can be financed with these credits. All firms, including majority foreign-owned companies, can apply through their regular commercial bank, which charges a 2% commission. Similar credit agreements are currently being worked out with Colombia, Argentina and Venezuela.

Fomex and Bancomext also make available financing to the in-bond industry, to firms located in the border zone (a 20-km strip along the northern border) and to companies that supply the border zone. To be eligible, firms must manufacture goods with at least 30% local content and generate foreign currency the equivalent of 30% of their total sales or avoid outflows of that amount through import substitution. These companies must be established in Mexico. Financing is available for the purchase of machinery and equipment up to 85% of the investment cost in pesos or dollars. Terms and rates are the same as Fomex import credits for exporters—9.5% on two- to five-year credits and 9.8% on credits over five years.

Fomex funds 100% of production costs for goods with at least 60% local content and 100% of the Mexican components for goods with 30–60% local content. The term is from the moment of purchase of raw materials until the goods are sold, and the cost is CPP plus five percentage points, payable semiannually during an amortization period set by Fomex.

Fomex also provides working capital to majority Mexican-owned companies that manufacture capital goods or products with a high added value and contribute to import substitution. Production financing is given for the period covering raw material purchase to delivery of the final product—up to 100% of the production cost or 70% of the invoice value. The minimum amount is P10 million, and no ceiling is set. Interest is CPP plus two percentage points.

Dollar financing for raw-material imports is also available at LIBOR or prime plus a commission ranging from 0.5% to 2%, based on the bank's cost of funds and the client's creditworthiness. The Counter Receipt Financing program is available to Mexican and majority foreign-owned Pemex suppliers. It allows companies to borrow up to 85% of the amount of their Pemex account receivable, up to a maximum of P1 billion annually at CPP plus two. Firms are not permitted to participate in both programs for the same Pemex order.